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Invested in America

December 5, 2013

Via Electronic Mail (rule-comments@sec.gov)

Chair Mary Jo White
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Securities Information Processors and Operational Resiliency

Dear Chair White:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] submits this letter in response to your recent statement in connection with the review by the Securities and Exchange Commission ("Commission") of the operation of the Securities Information Processors ("SIPs").[2] We appreciate the Commission's leadership in examining these important issues in light of the August 22, 2013 SIP outage that led to a halt in trading of Nasdaq-listed securities. The August 22nd events highlighted the critical nature of the SIPs in maintaining fair and orderly markets and emphasized the need for regulators and market participants to coordinate and collaborate to make sure the markets are operationally resilient and robust.

We support your direction to the self-regulatory organizations ("SROs") to work collaboratively on these issues with all market participants, including the broker-dealer community. As you know, the SROs announced on November 12, 2013 that they have agreed among themselves on certain recommendations and preliminary implementation timetables in response to their September 12, 2013 meeting with you. Before their November 12th announcement, the SROs engaged SIFMA and its members to present us with their preliminary approaches to the workstreams you identified in September. We understand the SROs' initial need to scope out the issues among themselves before consulting with other industry members. It is important to note, however, that SIFMA and its members have not reviewed any detailed SRO proposals or analysis. As such, we have not yet had the opportunity to provide substantive feedback on the SROs' recommendations. We look forward to providing detailed comments on specific proposals as they are developed and made available.

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1 SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

2 *See* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539804861#.Unpu3VCfgqY

As described below, SIFMA has initial points of view on the five workstreams that you identified after your September 12th meeting with the SROs. However, as this review process moves from preliminary concepts to concrete proposals, it is imperative that the broker-dealer community play an active role in developing proposals without simply waiting for public comment after proposals are filed with the Commission. The unique expertise and insight of the broker-dealer community complements that of the SROs. We believe the SROs should fully integrate the broker-dealer and investment community into their workstreams associated with your request for review, as we believe such collaboration will greatly benefit and enhance the proposals that will be subsequently developed. In this way, the specific proposals will be more fully developed than will be the case if industry participation is limited to responding during the comment process.

From a broader perspective, we believe the August 22nd SIP outage is a symptom of the outdated system by which critical market data – the best bids, offers, and last sale prices in the equities markets – is controlled and distributed. The system was designed more than 30 years ago, and it has been nearly a decade since the Commission examined the issue, which was at a time when the benchmark for execution speed was one second.[3] Over that time, markets have evolved dramatically through the processing power of today's technology – with execution times measured in milliseconds and microseconds – as well as widespread retail investor participation in the markets, decimalization, the exponential growth of daily trading volume, and the for-profit status of the securities exchanges. In today's markets, the current system suffers from a lack of transparency and competition, questions of underfunding, and insulated governance. We believe the time is ripe for reconsidering how the SIPs are governed, controlled, and operate under the Commission's oversight. Accordingly, as described in more detail below, we urge the Commission to work with the SROs and industry members to examine the operation and organization of the SIPs more broadly and develop broader action plans for the SIPs that (1) revamp governance and address conflicts of interest, (2) increase transparency in operations, and (3) provide for increased efficiencies, including the introduction of competitive forces.

SIFMA'S INITIAL POINTS OF VIEW ON WORKSTREAMS

SIFMA and its members have discussed your five workstreams and have developed initial points of view on addressing them. For your convenience, the workstreams are set forth below, followed by our initial views.

1. Provide comprehensive action plans that address the standards necessary to establish highly resilient and robust systems for the securities information processors (SIPs), including testing standards and disclosure protocols.

[3] *See* Securities Exchange Act Release No. 51808 (June 9, 2005), 79 FR 37496 (adopting Regulation NMS).

SIFMA Point of View: The action plans for the SIPs should include short-term solutions to provide for redundancy and operational resiliency. This plan should include both an initial plan to address redundancy and resiliency issues in the short-term (such as establishing "Hot/Warm" capabilities with the SIPs' existing back-up sites) and a longer-term plan to comprehensively address redundancy and resiliency issues. Other areas that should be considered in the short term include:

- Requiring markets that report to the SIPs to enter into service level agreements with performance criteria they must maintain (*e.g.*, timestamp comparison deltas, out of sequence updates, duplicate messages, latency, outstanding heart beats) in order to remain connected. If a market does not satisfy the SLA, then the SIP should be permitted to disconnect that market's session and zero out its quotes.

- Requiring markets that report to the SIPs should be required to include "originating" timestamp and sequence numbers on quotes so that consumers of SIP data can monitor latency, detect problems, and reconcile the SIP data with the private data products.

- To reduce operational risk, adding new fields and indicators to the SIP feeds only if they are absolutely necessary for the benefit of the entire market and not using the SIPs to disseminate fields and indicators that are specific to one market.

2. Identify and provide assessments of the robustness and resilience of other critical infrastructure systems.

SIFMA Point of View: It is essential to identify market-related single points of failure and develop appropriate contingencies to minimize market impact resulting from operational issues affecting those critical infrastructure items. In our comment letter on the Commission's proposed Regulation SCI, we identified industry entities that provide critical infrastructure systems to the markets.[4]

3. Provide SIP plan and/or rule amendments addressing the issuance, effectiveness, and communication of regulatory halts.

SIFMA Point of View: Clear and consistent messages for each case of a trading halt should be disseminated in a timely manner from multiple recognized sources, such as the existing distinct quote and trade feeds on the SIP, or the direct feeds from the exchanges; we do not believe that a new "halt" feed is necessary. All of the halt messages from each source should include sufficient information to identify the nature of the halt (*e.g.*, limit up-limit down) or whether it results from an outage at a particular exchange. In particular, the halt messages should be clear at the time

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4 *See* Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA, to Elizabeth M. Murphy, Secretary, Commission (July 8, 2013). *Available at* http://www.sec.gov/comments/s7-01-13/s70113-50.pdf

the halt is declared whether the halt is regulatory or non-regulatory; a trading halt should not be declared regulatory after the fact.

4. Review SRO rules relating to the trade break process and procedures to reopen trading following a trading halt, and provide amendments to those rules as necessary.

SIFMA Point of View: SRO rules relating to trade breaks should be uniform across markets and should be clear and uncomplicated; SIFMA's Listed Options Trading Committee has been working over the last year to develop proposals for harmonized error rules at the various options exchanges. In addition, all decisions to resolve and trade busts resulting from a trading halt should be made publicly announced *before* the resumption of trading, consistent with the terms of the market data plans; that process was not followed on August 22nd.

5. Provide rule amendments to implement "kill switches" that would allow exchanges to shut down trading in the event of technological failures, and review and consider other potential risk mitigation mechanisms.

SIFMA Point of View: We support the development of effective kill switch mechanisms, and we look forward to continued coordination with the SROs to develop workable functionality to put kill switches into place. The kill switch mechanisms should have consistent calculation methodologies across markets. In addition, the kill switch mechanisms should use standard identifiers to set thresholds and group sources of orders upon which the calculations apply. We also believe the development of kill switch mechanisms should be coordinated with the ongoing development of risk management tools by the Depository Trust and Clearing Corporation.

SIFMA FEEDBACK ON BROADER ISSUES

In light of the recent events involving the SIPs, the Commission should review and amend the overall governance and operational constructs of the SIPs. At the heart of the organization of the SIPs is the national market system ("NMS") plan construct that governs their operation. The recent events involving the SIPs, as well as other SRO-driven industry initiatives such as the development of the consolidated audit trail and the implementation of the limit up-limit down plan, have demonstrated the need to take a broader look at and reconstruct the way NMS Plans are developed and governed. Additionally, the Commission and the SROs should take steps to increase transparency and efficiency in the day-to-day operation of the SIPs.

Revamped Governance

The existing NMS Plan structure is outdated and should be modified. The NMS Plans should include direct representatives from the industry (both broker-dealers and asset managers) and the public, and those independent representatives should have voting power on the operating committees of the SRO plans. In particular, the Commission should direct the SROs to amend the NMS Plans governing the SIPs to incorporate the fair representation standards applicable to

SROs.[5] These steps would help assure that the SIPs operate for the benefit of the public good, not just for the benefit of the participating exchanges.

We understand that indirect industry participation in NMS Plan governance is available through advisory committee membership, but the advisory committee structure has been unsuccessful. Advisory committee members have no substantive voice in the operation of the SIPs, their role is without authority, and there is no mechanism for them to elicit or report feedback from the broad constituencies that depend on the SIP data. In addition, the SROs regularly conduct the meaningful business of the SIPs in executive session, from which advisory committee members are excluded. This was the case recently when the operating committee of the UTP SIP Plan conducted a post-mortem of the August 22nd events in executive session without the advisory committee members, who were simply briefed *after* the executive session.

Improving the governance of the SIPs is particularly important because of the conflicts of interest inherent in the SIP operations. In particular, the SIPs are operated by exchanges that also offer competing data products. Eventually, the SIPs should be restructured to be independent, and a review should be conducted to evaluate whether SIP operators should be permitted to operate competing data product offerings and vice versa.

Increased Transparency

The SIPs should operate with much greater transparency than they currently do. In this regard, the Commission should direct the SROs to amend the NMS Plans governing the SIPs to provide disclosure commensurate with their roles as utilities critical to the integrity of market infrastructure. At a minimum, this increased transparency should include public disclosures of operations, accounting, and technology. Both the Commission and the public should be able to review the SIPs' revenues, expenses, budgets, investment plans and audited financials.

The SIPs should provide periodic public disclosure of their operational capabilities and performance metrics, including: latency statistics at multiple percentiles (including peak vs. non-peak), capacity and throughput, time for consolidation of quotations by time of day, etc. In addition, the SIPs should publish data tracking the speeds and latencies for provision of data to the SIP by venue. The SIPs also should publish data on latencies from publishing market centers and frequency of locked and crossed market conditions.

The SIPs should publicly report market data revenue allocation by venue, and they should publish descriptions of the technology infrastructure on which the SIPs are built and an accounting of the cost to operating this infrastructure. In this regard, the SIPs should report how the market data revenue pool is used to fund and improve the SIPs' technology infrastructure before it is distributed.

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5 *See* Section 6(b)(3) of the Securities Exchange Act of 1934.

Moreover, the SEC should request an independent technology audit of the SIPs, comparing them to industry standards, to one another and to the proprietary data products offered by exchanges. In addition, the SEC should request an independent financial audit of SIP finances and, in particular, the implementation of the market data revenue distribution formula. This audit should include an analysis of how the revenue formula is accounting for sub-second quotes in the formula and how sub-second quotes are being provided to SIP by Plan participants vs. how they appear in direct feeds. All of these audit results should be made publicly available.

Increased Efficiencies

SIFMA and its members have identified some preliminary areas to consider in addressing efficiencies in the operations of the SIPs and the dissemination of public data feeds. We look forward to coordinating with the Commission and the SROs to develop additional, more detailed solutions.

- As an initial matter, the Commission, with industry input, should study the appropriate depth of data that should be included in the public quote. The original concept of displaying the single best bid and offer in the market (which is often only a few hundred shares with no indication of the remaining interest for that security) may no longer be serving the National Market System's purpose of assuring fairness and transparency.

- Ultimately, there should be multiple SIP providers for each tape, including providers beyond exchanges, with revenue based on number of subscribers. This would allow consumers to choose among providers, yet still promote competition to promote improved service. In addition, introducing competition would incentivize SIP operators to create the highest quality products, to mandate rigorous minimum standards from SIP participants, and to compete with proprietary data products.

- Industry participants should work together to improve the ability to detect and remedy problematic market data. Various metrics can be used (*e.g.*, number of crossed markets and self-helps declared), with suspect data possibly marked as a "slow quote."

- A maximum allowable delta should be established for the SIPs (post consolidation) vs. direct data feeds set with respect to latency and speed, post consolidation, and those standards should be able to be met during peak periods of the trading day.

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We appreciate your consideration of our views on this matter. SIFMA looks forward to working with the Commission and the SROs as they undertake a comprehensive review of this critical area of equity market structure. We would greatly appreciate the opportunity to meet with you to discuss these issues with you in greater detail. If you have any questions, please contact me at (202) 962-7383 or tlazo@sifma.org.

Sincerely,

Theodore R. Lazo
Managing Director and
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