April 30, 2009

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Office of the Corporate Secretary
NYSE Euronext
20 Broad Street, 12th Floor
New York, NY 10005

Re: FINRA Regulatory Notice 09-15 and NYSE Information Memo 09-13

Dear Sir or Madam:

The Securities Industry and Financial Markets Association[1] ("SIFMA") appreciates the opportunity to comment on FINRA Regulatory Notice 09-15,[2] which requests comment on Proposed FINRA Rule 5320, and NYSE Information Memo 09-13,[3] which requests comment on the applicability of FINRA's Proposed Rule to the New York Stock Exchange ("NYSE") and NYSE Amex LLC ("Amex LLC") (collectively, the "Exchanges"). In its Proposed Rule, FINRA seeks to consolidate NASD Rule 2111 governing market order protection and NASD IM-2110-2 governing limit order protection. FINRA also seeks to harmonize its Proposed Rule with NYSE Rule 92, where appropriate.

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[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 600 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in Washington, D.C. and London, and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

[2] FINRA Regulatory Notice 09-15 (Mar. 2009).

[3] NYSE Information Memo 09-13 (Mar. 12, 2009).

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SIFMA is supportive of FINRA's Proposed Rule 5320 and believes that it is a substantial step forward in FINRA's efforts to harmonize its rules with the NYSE rules. Such standardization will provide significant benefits to all participants in the securities industry. As a result, we urge the expeditious submission of the Proposed Rule to the SEC, subject to several clarifications and revisions discussed below. In addition, we urge FINRA, as it considers this proposed rule change, to keep in mind the interplay between this proposal and proposals regarding other related rules (such as Proposed Rule 5270 regarding frontrunning) to ensure a consistent and coherent approach to how firms handle customer orders.

Furthermore, to facilitate the goals of regulatory consistency and simplification of compliance obligations, SIFMA urges NYSE Regulation to replace each Exchange's Rule 92 only with a rule identical to FINRA's final rule.[4] In light of the increasing automation and the move to competing liquidity providers on exchanges, SIFMA does not believe that there are significant and relevant differences between trading on the Exchanges and trading on other markets that would warrant an Exchange rule different from FINRA's rule.[5] To this end, SIFMA is providing comments on both the FINRA and NYSE proposals in this letter.

I. FINRA's Request for Comments

SIFMA is supportive of FINRA's Proposed Rule 5320. Subject to several recommended modifications with regard to the large order and institutional account exception in Proposed Rule 5320.01 and the no-knowledge interpretation in Proposed Rule 5320.02, as discussed in more detail below, SIFMA recommends that FINRA move forward without delay with the rule proposal.

A. Disclosure Related to Large Orders and Institutional Accounts

SIFMA agrees with FINRA's decision to include the exception for large orders and institutional accounts in Supplementary Material .01, as the exception provides firms with the regulatory flexibility to supply needed liquidity for larger orders.[6] This provision permits a firm to negotiate specific terms and conditions under which the firm may continue to trade alongside of, or ahead of, certain large orders or orders submitted for an institutional account, provided such terms and conditions are clearly disclosed and explained to the customer. SIFMA believes that disclosing to such customers the terms and conditions that would be imposed on these orders would provide more than adequate customer protection.[7] In contrast, SIFMA believes that affirmative consent (for example, a blanket one-time consent from customers or individual order-

[4] Indeed, SIFMA supports a move to harmonize such rules across all exchanges.

[5] See, e.g., Exchange Act Rel. No. 58845 (Oct. 24, 2008) (describing NYSE's implementation of a new trading model, including the elimination of the specialist category); NYSE Arca Rule 6.16 (NYSE affiliate exchange currently enforces a rule substantially similar to FINRA's Manning Rule).

[6] Exchange Act Rel. No. 34279 (June 29, 1994).

[7] SIFMA intends that the term "disclosure," as used here, be interpreted in the same manner as the phrase "negative consent with disclosure."

by-order consent from customers) has resulted in significant burdens and costs on both customers and firms, without significantly furthering the goal of customer protection in any tangible way.

An affirmative consent requirement imposes significant administrative burdens and costs on customers and firms without any commensurate benefit to the customers. The firms' experience with the current affirmative consent requirements under Rule 92 are instructive. Many firms do not rely on blanket consent because of the difficulty of providing the required disclosures upfront and prior to any trading.[8] Therefore, most firms obtain order-by-order consent, which raises a variety of issues for both the customer and the firm.

First, requiring affirmative consent for each trade impacts a firm's ability to handle a customer's order in the most expedient way possible, often significantly disadvantaging customers for little or no beneficial reason. For example, obtaining the consent at the time of the trade, or checking to see if an appropriate consent is available, imposes unnecessary delays in the trading process. Similarly, the logistical burden of affirmative consent, at times, may impact firms' ability to provide capital. For example, a firm handling agency orders on a desk may encounter difficulty committing capital to a subsequent order that is more easily executed on a principal basis. To do so, the firm would have to ensure that it received affirmative consent from all agency orders on the same side of the market as the firm's principal trade. An affirmative consent requirement also could impact a firm's ability to timely hedge its exposure in connection with a proposed principal trade, thereby impacting the willingness of the firm to commit capital in the first instance.

Second, obtaining affirmative consent is a manually intensive process, requiring significant supervisory, compliance, legal and business resources. Affirmative consent also presents technology issues as trading systems must be customized to take into account the consent process. For example, in order to comply with an affirmative consent rule, a broker-dealer's tracking tools that reflect the receipt of consent per customer would have to be systemically linked to the firm's order management systems in order to distinguish order-handling methodology per client and flag customers which have provided consent for sales traders. Our understanding is that most firms have not had to link the consent tracking tools to their order management systems, so the methodology would have to be created, and would be extremely burdensome and costly. Trading must be supervised to ensure compliance with consents, including monitoring and responding to real-time alerts. Compliance personnel must surveill the process for obtaining consents to determine that the traders act in accordance with such consents (or lack thereof), which involves the manually intensive process of following up on possible exceptions. Compliance personnel also must respond to Rule 92 regulatory inquiries, which involves trade reconstruction, document production and related efforts. All of these efforts, by necessity, require significant resources from legal, compliance and business

[8] For example, under Rule 92, the NYSE prohibited firms from obtaining blanket affirmative consent to percentage split allocations that are variable depending on the specifics of a particular trade. NYSE Information Memo 07-107 (Nov. 9, 2007). Because the split allocations often vary, many firms determined it was not practicable to utilize blanket affirmative consent and consequently continued to obtain trade-by-trade consent.

personnel. Moreover, this Rule has resulted in significant outside counsel costs for many firms. Finally, the burden associated with obtaining the necessary affirmative consent from customers cannot be underestimated, especially since it introduces a significant (and largely unpredictable) variable into the process – the timeliness of the customer response.

In contrast, disclosure of the relevant terms and conditions, as in the existing FINRA Rule, is easier for firms to control and implement and provides direct disclosure to customers without the administrative burden of ensuring that customers return a response. Furthermore, as a practical matter, current compliance with the FINRA requirements is highly automated, which significantly reduces unnecessary burdens on firms. Finally, we are not aware of any empirical data to suggest that institutional orders in NYSE-listed securities are afforded any more protection than orders in Nasdaq-listed securities.

Moreover, in the past, regulators have recognized in various contexts that disclosure provides appropriate customer protection, without the costs and practical difficulties associated with affirmative consent.[9] For example, the NYSE permits firms to provide disclosure about trading practices to customers without obtaining affirmative consent when executing certain proprietary orders while holding customer orders executable at the same price (e.g., with respect to volume weighted average price ("VWAP") trades).[10] In addition, traditionally under NYSE Rule 108, the NYSE permitted specialists to trade along with the crowd when establishing or increasing the specialist's position, provided that the specialist announces its intention and provides the floor brokers with a reasonable opportunity to object. Floor brokers, in turn, are obligated to disclose to their customers that a specialist may trade along under these circumstances. As such, specialists may trade along subject to their providing appropriate disclosure.[11] Similarly, NASD Rule 2441 permits firms to obtain negative consent with regard to net transactions with institutional customers.[12] We are unaware of any information that

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[9] In addition, the SEC and the self-regulatory organizations regularly rely on disclosure of information that is important to customers. See, e.g., Rule 10b-10 under the Exchange Act (describing disclosure requirements with regard to payment for order flow); Nasdaq Rule 4631 (describing disclosure requirements with regard to risks related to extended hours); and FINRA Rule 2265 (describing disclosure requirements with regard to extended hours trading).

[10] NYSE Information Memo 05-52 (Aug. 1, 2005). Moreover, it had been our understanding, based on discussions with senior officials from the NYSE and NASD in October 2005, that the NASD and the NYSE intended to issue joint guidance harmonizing their views on these VWAP disclosures in a manner consistent with NYSE Information Memo 05-52. Unfortunately, such guidance was never issued, thereby leaving the guidance set forth in NASD Notice to Members 05-51 (Aug. 2005) in place.

[11] NYSE Information Memo 07-86 (Aug. 22, 2007).

[12] NASD Rule 2441(c)(1) provides that a firm may obtain an institutional customer's consent through "a negative consent letter that clearly discloses to the institutional customer in writing the terms and conditions for handling the customer order(s) and provides the institutional customer with a meaningful opportunity to object to the execution of transactions on a net basis. If the customer does not object, then the member may reasonably conclude that the institutional customer has consented to the member trading on a 'net' basis with the customer and the member may rely on such letter for all or a portion of the customer's orders (as instructed by the customer) pursuant to this Rule."

suggests disclosure in these other contexts has resulted in less customer protection than affirmative consent.

SIFMA believes that disclosure advising institutional accounts and customers with large orders of the terms and conditions that would be imposed on their orders would be adequate if it were provided at account opening and annually thereafter, as proposed with regard to FINRA's no knowledge exception.[13] Customers and firms pay most careful attention to the terms and conditions of trading and other documentation details at the initiation of the customer-dealer relationship. Therefore, parties are well served by the exchange of documentation that clearly identifies the trading policies of the firm at that time, so that customers can determine at the initial point of contact how their orders should be handled.[14] Moreover, the account opening and annual disclosure requirements must serve to alert the customer to the different ways in which any particular trade may be handled, but they should not prevent variability in the way any particular trade may be handled.[15] Finally, SIFMA also believes it should be permissible to provide such disclosures via email or a firm's website.[16] We note that the NYSE currently permits appropriate web-based disclosures with regard to the required blanket trade-along consents under Rule 92.[17]

B. Expansion of No-Knowledge Interpretation for Both Exchange-Listed and OTC Equity Securities

SIFMA fully supports FINRA's decision to adopt the NYSE no-knowledge standard in its Proposed Rule 5320.02(A) regarding exchange-listed securities. SIFMA, however, recommends that FINRA apply the same NYSE-based standard to OTC securities, including securities traded on the pink sheets and bulletin board facilities as well. Accordingly, SIFMA urges FINRA to eliminate paragraph (B) of Proposed Rule 5320.02 and to apply paragraph (A) to OTC equity securities in addition to exchange-listed securities.

FINRA predicates its proposed change in practice with regard to exchange-listed securities on the changes in handling such securities. As FINRA accurately describes, when the existing no-knowledge interpretation was adopted, most retail order flow was handled by a firm's market making desk. Now, however, as FINRA describes in its Notice, many firms "prefer to handle retail-sized customer orders on an automated basis, separate and apart from the firm's proprietary trading desks, including the market making desk. Such orders may be routed

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[13] Proposed FINRA Rule 5320.02. See also FINRA Rule 2341 (requiring margin disclosure at account opening and annually thereafter).

[14] SIFMA also believes that the required disclosures regarding a firm's order handling practices (including the disclosures required under Proposed Rule 5320.01, Proposed Rule 5270, and with regard to guaranteed priced orders as described in Notice to Members 05-51) should be combined into one document.

[15] See, e.g., n. 8.

[16] See, e.g., FINRA Rule 2341 (permitting disclosure "electronically").

[17] NYSE Information Memo 07-107 (Nov. 9, 2007).

through algorithmic systems that automatically search out the market centers offering liquidity and immediate execution at the best available prices."[18] Accordingly, SIFMA agrees with FINRA that the evolution of the market for exchange-listed securities makes FINRA's existing approach to the no-knowledge exception obsolete. As such, SIFMA believes that the expansion of the no-knowledge interpretation to include the market making desk with respect to exchange-listed securities is warranted.

We disagree, however, that the market for OTC equity securities has not evolved as well. Indeed, in many cases, the markets for exchange-listed securities and OTC equity securities operate in the same manner. In other cases, SIFMA believes that the market is indeed evolving in the same manner as the market for exchange-listed securities, and that such evolution warrants the adoption of the NYSE standard. Such a change would provide firms with the flexibility to adapt their order routing practices as changes occur without sacrificing customer protection. Moreover, and notwithstanding any changes in the application of the knowledge standard to exchange-listed and OTC securities, firms would be required to execute orders for such securities in conformance with FINRA's best execution requirements.[19]

Moreover, SIFMA believes that the harmonization process between FINRA and NYSE rules is intended to bring consistency to FINRA's rule set; ideally, this process should not just codify two different rules for the same issue. FINRA's proposal, we believe, would do just that – impose the legacy NYSE standard on the exchange securities and impose the legacy NASD standard on OTC securities. Such an approach introduces unnecessary complexity into the Proposed Rule, where the goal of customer protection would be appropriately served by the application of the NYSE no-knowledge standard to both exchange-listed and OTC securities.

C. No Separate Identification of Walled-Off Desks

As part of the adoption of the NYSE standard for the no-knowledge exception, FINRA asks whether it should require firms to identify separately order and trading activity by walled-off desks for purposes of regulatory reporting (i.e., transaction and OATS reporting). SIFMA believes that such order-by-order surveillance methods – through separate market participant identifiers ("MPIDs") or otherwise – goes beyond what is necessary. Introducing numerous new MPIDs would only serve to make OATS and other regulatory reporting even more complex and expensive than it already is, and would provide more opportunities for operational and technical problems with such reporting. Moreover, information barriers have been used successfully in this and a variety of other regulatory contexts to control the improper flow of information – without the need to track trading information through separate MPIDs.[20]

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[18] FINRA Regulatory Notice 09-15 (Mar. 2009).

[19] See NASD Rule 2320.

[20] See, e.g., Rule 200(f) of Regulation SHO (regarding aggregation units).

Instead, SIFMA believes that the Proposed Rule should require firms to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent the prohibited trading under the Proposed Rule. As such, enforcement of the Proposed Rule should not be on an order-by-order basis, but on whether reasonable policies and procedures have been established, maintained and enforced. The SEC took a similar approach in its implementation of Regulation NMS,[21] and has sought comment on a "policies and procedures" based short sale pricing rule.[22] Such an approach would provide individual firms with the flexibility to address the surveillance issue in the best way for each particular firm, whether that be information barriers, separate MPIDs and/or other measures.

D. Application of Proposed Rule to After-Hours Trading

SIFMA is concerned with the impact to systems and procedures if the Proposed Rule were to apply to after-hours trading. Other related rules, like Regulation NMS, do not apply outside of regular trading hours.[23] Generally, we consider customers that send orders for after-hours trading to be more sophisticated and, hence, we believe such orders should be handled like institutional orders even if they are smaller in size or submitted by an individual investor. Therefore, SIFMA believes that the Proposed Rule should apply only to regular trading hours.

II. NYSE Regulation's Request for Comments

The Exchanges each plan to file with the SEC a proposed rule to replace each Exchange's Rule 92 with a rule "similar" to Proposed FINRA Rule 5320.[24] SIFMA does not believe that the Exchanges should adopt a rule that differs from the FINRA final rule in any substantive way. In particular, SIFMA does not believe that there are any issues specific to trading on the Exchanges, including issues related to floor members, upstairs member organizations or market structure generally, that would warrant different regulatory treatment. Where, as here, there is no factual justification for divergent provisions, SIFMA believes that the goals of regulatory consistency and simplification of compliance obligations should take precedence.[25]

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[21] See Exchange Act Rel. No. 51808 (June 9, 2005) (noting that such policies should be reasonably designed to prevent trade-throughs, but were not expected to completely eliminate trade-throughs).

[22] Exchange Act Rel. No. 59748 (Apr. 10, 2009).

[23] See Rules 600(b)(64) and (77) of Regulation NMS.

[24] NYSE Information Memo 09-13 (March 12, 2009).

[25] As FINRA and the Exchanges work toward a harmonized rule, we urge them to consider the various practical market concerns with their respective rules that have been raised over the years. For example, SIFMA recommends that FINRA address in its proposed rule or in an interpretation thereto the practical trading concerns that the NYSE identified when it adopted the so-called "black box exemption" from current NYSE Rule 92. See NYSE Information Memo 2001-33 (Oct. 8, 2001). SIFMA believes that the NYSE correctly identified a valuable and practical need in the market with this exception. More generally, it is important that firms may continue to rely on guidance issued by FINRA and the NYSE over the years with respect to the use of information barriers to address trading ahead and similar regulatory concerns. See, e.g., NYSE Information Memo 2001-21 (Aug. 9, 2001); NASD Notice to Members 05-51 (Aug. 2005).

A. Execution Standard for Timing of Customer Protection

NYSE Regulation requests comment on whether it should adopt FINRA's proposed timing for its customer protection obligations under Proposed Rule 5320. FINRA would continue to limit a firm's trading based on knowledge of an unexecuted customer order at the time of the *execution* of the proprietary order. In contrast, Rule 92 traditionally prohibited the *entry* of the proprietary order once a proprietary trader had knowledge of an unexecuted customer order. SIFMA is in favor of the use of the execution time, not the entry time, as the appropriate standard. With the recent trends towards flickering quotes and electronically-routed orders, compliance with the Proposed Rule is more straightforward if execution time is the adopted standard. There are many cases where a firm is working firm and customer orders at the same time with multiple limit orders placed in the various markets. When a new customer order arrives, it makes more sense to protect the new order with any potential fills from existing outstanding firm orders, as opposed to canceling the outstanding firm order until the firm fills the new customer order. Moreover, SIFMA does not believe that this change in timing would impact a floor broker or other Exchange member's ability to handle customer orders or effectively represent those orders. As such, SIFMA believes that FINRA and the Exchanges should adopt the existing FINRA standard, which is timed from the *execution* of the proprietary order.

B. Disclosure for Institutional Customers and Large Orders

Like FINRA, NYSE Regulation requests comment on whether an affirmative consent or negative consent with disclosure is appropriate prior to trading along with or ahead of institutional customers and large orders, noting that current Rule 92(b) requires affirmative written consent or order-by-order consent. As discussed above, SIFMA supports a regime of disclosure for both FINRA and Exchange Rules.

C. Elimination of Limitations on Permissible Transactions under Rule 92(b)

Under current Rule 92(b), a member organization may only enter certain transactions (i.e., liquidating transactions, bona fide hedge and bona fide arbitrage) when trading along with institutional accounts and large orders. In contrast, the Proposed FINRA Rule imposes no such limitations. SIFMA agrees with the NYSE proposal to eliminate the Rule 92(b) limitations on the types of transactions that a member organization may enter into when trading along with an institutional account or large orders, and instead adopt the general terms and conditions of the FINRA proposal. SIFMA believes that information barriers should be sufficient without also restricting the type of trade that may be entered absent knowledge of an unexecuted customer order. In addition, such limitations on permissible transactions do not exist under the existing FINRA Rule, and there has been no indication that this has compromised customer interests.

D. FINRA's Definition of Institutional Account

Currently, the Exchanges rely on the definition of "institutional account" set forth in Rule 92.50, whereas FINRA proposes the use of the definition of "institutional account" in FINRA Rule 4512. Unlike the FINRA Rule, the definition in Rule 92.50 does not include a natural person with total assets of at least $50 million to be an "institutional account." SIFMA notes that the inclusion of natural persons with total assets of at least $50 million has not proven problematic under the FINRA rules; generally, such persons are sophisticated in their trading or have access to appropriate professional advice. Therefore, SIFMA recommends that NYSE Regulation adopt FINRA's definition of "institutional account."

E. Riskless Principal Exception

SIFMA supports the NYSE's adoption of FINRA's approach to riskless principal trades for the Exchange Rules, as set forth in Proposed Rule 5320.03. As the NYSE notes, adopting the FINRA approach moots the current issues relating to the differences between the application of the Rule 92(c) riskless principal exception and the Manning Rule riskless principal exception. In particular, SIFMA supports the harmonization of FINRA's and the Exchanges' allocation requirements, which would include the requirement to allocate the offsetting principal transaction to a riskless *principal or customer* account in a consistent manner and within 60 seconds of execution. Currently, the NYSE Rule 92 required such allocation only to a *customer* account.

As the NYSE notes in its Information Memo, even if the Exchanges adopt Rule 5320.03, the Exchanges would continue to have a rule that requires member organizations to submit a report contemporaneously with the execution of the facilitated order that identifies the trade as riskless principal. NYSE requests comment on how such reporting requirements should be met. SIFMA believes that the NYSE should work with FINRA to harmonize their riskless principal reporting rules, and to consolidate their audit trails for these transactions. With that goal in mind, SIFMA does not believe that the implementation of the NYSE's Front End System Capture ("FESC") system – a new reporting scheme that would require disparate systems and reporting procedures for firms – provides a workable solution to riskless principal reporting. Instead, during the harmonization process, NYSE should be flexible and allow multiple methods for firms to satisfy the NYSE's need for this surveillance data, including permitting the use of any TRF for capturing the riskless principal leg of the trade. For example, many FINRA and NYSE members use the FINRA NASDAQ TRF, rather than the NYSE TRF, for trade reporting currently. Requiring firms to establish a FESC or NYSE TRF connection merely for the purposes of reporting the NYSE-related events that are otherwise reported to the NASDAQ TRF currently would impose unnecessary expense and effort on the firms. In the longer term, a reporting and surveillance regime that utilizes ACT and OATS in lieu of FESC and OTS may be the most appropriate solution, and any interim steps or changes should be consistent with this long-term goal.

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SIFMA appreciates the opportunity to provide comments to FINRA on Proposed Rule 5320, and to NYSE Regulation regarding its related request for comments. SIFMA would be pleased to discuss any comments herein with FINRA and NYSE Regulation, or provide FINRA and NYSE Regulation with any additional assistance as it proceeds with the rule proposals. If you have any questions or comments, please feel free to contact me at 202-962-7300.

Sincerely,

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Managing Director and Associate General Counsel

cc: Marc Menchel, FINRA
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