November 25, 2008

The Hon. Christopher Cox, Chairman
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Commission Guidance Concerning Proposed Rule Changes Filed by Self-Regulatory Organizations (SEC Release No. 34-58092)

Dear Chairman Cox:

The Securities Industry and Financial Markets Association ("SIFMA")[1] would like to express its views regarding guidance released by the Securities and Exchange Commission's (the "SEC" or "Commission") relating to Rule 19b-4 under the Securities Exchange Act of 1934 ("Exchange Act").[2] Although the New Guidance Release did not formally solicit comment, we believe that the changes discussed therein are sufficiently significant to warrant industry comment. In particular, the New Guidance Release: (1) dramatically increases the number of proposed rule changes issued by self-regulatory organizations ("SROs") that may become immediately effective upon filing with the Commission, and (2) removes the ability of the Director of the Division of Trading and Markets ("Division") to abrogate SRO rule filings pursuant to delegated authority, which may effectively preclude abrogation of immediately effective SRO rules before their respective operative dates and, possibly, before the expiration of the 60-day statutory period for abrogation under Exchange Act Section 19(b)(3)(C).

At the outset, SIFMA acknowledges that the New Guidance Release is part of the SEC's ongoing efforts to simplify and streamline the SRO rule review process. The release responds to assertions by national securities exchanges that they are facing increased competitive pressures from various entities (*e.g.*, foreign exchanges, futures

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[1] SIFMA brings together the shared interests of more than 650 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 New York, Washington DC, and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. More information about SIFMA is available on its website at *www.sifma.org*.

[2] SEC Release No. 34-58092 (July 3, 2008), 73 Fed. Reg. 40144 (July 11, 2008) (the "New Guidance Release").

exchanges, electronic communication networks and alternative trading systems) that trade the same or similar products and can implement changes without Commission review. Although SIFMA is not aware of an instance where one of these non-SRO entities has used the Commission's rule-approval processes as a mechanism to obtain first-to-market advantage over SROs, we are generally in favor of regulatory simplification and more efficient agency action on SRO rulemaking if and to the extent those improvements can be accomplished without compromising the safeguards in the Exchange Act.[3] Overall**,** SIFMA appreciates the need for innovation and regulatory flexibility in the rapidly changing securities markets. Moreover, SIFMA strongly supports efforts to expedite the harmonization of disparate SRO rules, such as the ongoing consolidation of the legacy NASD and NYSE rulebooks into the new FINRA rulebook.

Nevertheless, SIFMA is concerned that the New Guidance Release will not enhance investor protection or provide greater regulatory certainty. Notwithstanding inherent delays, notice and comment periods are an essential component of the regulatory process, enabling interested parties to provide valuable information about market practices and potential consequences. Although all rule changes require members of SROs to make some degree of adjustment, immediately effective rules present greater compliance challenges, impose commensurately higher costs, and potentially result in market disruption. Accordingly, the desire to move swiftly must always be balanced against the goal of moving effectively and in cooperation with the persons being regulated.

We believe that the New Guidance Release will increase the likelihood of inefficient or otherwise potentially deficient SRO rulemaking. Indeed, SIFMA has long been concerned about the potential negative consequences of broadening the scope of immediately effective SRO rules, particularly trading rules.[4] We revisit some of these concerns below as they may relate to the specific examples of potentially immediately effective SRO rule filings in the New Guidance Release.

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[3] For example, SIFMA notes the fact that alternative trading systems ("ATSs") in the United States are not regulated as heavily as national securities exchanges is the result of a careful, deliberative Commission decision several years ago that they are not in need of the same level of regulation for a variety of reasons. The regulatory treatment of ATSs does not argue for relaxation of the statutory standards and public procedures the Congress built into exchange regulation as part of the Securities Acts Amendments of 1975.

[4] *See* Securities Industry Association ("SIA") letter from Christopher Franke, Joseph Polizzotto, Peter Cohan and Michael Stone to Jonathan Katz dated April 6, 2001 ("Rule 19b-6 SIA Letter") (commenting on proposed, but never adopted, Rule 19b-6). In brief, this comment letter highlighted SIA's concerns that immediately effective SRO rules would often fail to provide firms with adequate time to take the necessary preparatory steps to ensure compliance. Rather, firms may have to hastily commit time and resources to comply with immediately effective SRO rules, or face regulatory liability. Such rushed compliance only increases the risks of mistakes, confusion, added costs, system disruptions and market risk, which all adversely impact markets and detract from customer protection. Thus, the authors of the Rule 19b-6 Letter believed, and SIFMA continues to believe, that the Commission should carefully evaluate the countervailing policy considerations to the SROs' requests for expedited rules.

SIFMA also believes that the New Guidance Release represents a significant broadening of the guidance issued by the Commission when the "non-controversial" category was first adopted under Rule 19b-4 in 1994.[5] SIFMA notes that it is a well-established principle of administrative law that agency interpretations, even when reasonable constructions of an agency's rules, trigger notice and comment requirements under the Administrative Procedures Act ("APA") when a later rule interpretation represents a significant change from a previous, definitive interpretation.[6] A change of this nature also requires substantial justification so as not to appear arbitrary and capricious.[7] Accordingly, SIFMA believes that, at least as a prudential matter and possibly as a legal matter, the Commission should have issued the New Guidance Release as a Commission rulemaking effort open to public comment.

The New Guidance Release summarily notes that the Commission has rescinded the delegated authority under which the Director of the Division could abrogate immediately effective SRO rule filings under Section 19(b)(3)(C) of the Exchange Act.[8] In effect, the responsibility for abrogation now rests solely with the Commission. It is not clear why this change was made because we are not aware of any instance when this previously delegated authority was used injudiciously, nor does there appear to be a clear benefit from reserving this responsibility to the Commission. As SIFMA has previously noted in prior correspondence with the Commission, there are numerous instances in which SRO rules have gone effective upon filing and only a handful in which such rules were thereafter abrogated.[9]

SIFMA is concerned that this change will make it virtually impossible for an immediately effective SRO rule to be abrogated before it becomes operative—*i.e.*, 30 calendar days after the date of filing or such shorter period as the Commission may designate—because of the difficulties in scheduling and arranging for Commission action. We also are concerned that it may reduce or even eliminate any meaningful chance that the staff of the Commission will have sufficient time to recommend that the Commission itself abrogate an immediately effective SRO rule, even in the face of well-founded public objection to the SRO rule, before the rule becomes operative.

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5 *See* SEC Release No. 34-35123 (Dec. 20, 1994), 59 Fed. Reg. 66692 (Dec. 28, 1994) (the "Prior Guidance Release").

6 *See* Alaska Professional Hunters Association, Inc. v. FAA, 177 F.3d 1030 (D.C. Cir. 1999). *See also* Paralyzed Veterans of America v. D.C. Arena, 117 F.3d 579 (D.C.Cir.1997).

7 *See, e.g.*, Goldstein v. Securities and Exchange Commission, 451 F.3d 873 (D.C. Cir. 2006).

8 This delegated authority was previously provided for in 17 C.F.R. § 200.30-3(a)(58).

9 *See* letter dated July 1, 2008 from Ira D. Hammerman, Senior Managing Director and General Counsel, SIFMA, to the Commission re SEC Release No. 34-57973 (June 16, 2008), available through http://www.sec.gov/comments/sr-nasdaq-2008-050/nasdaq2008050.shtml.

I. Prior Notice and Comment Fosters Effective and Efficient Rulemaking

The public notice and comment procedures under Section 19(b)(1) of the Exchange Act serve several fundamental policy objectives. Chief among them are regulatory efficiency and transparency.[10] Specifically, such procedures ensure that affected parties are afforded a reasonable opportunity to review and question SRO action prior to implementation. Likewise, the process enables parties of differing perspectives to provide additional information and alternative solutions not always contemplated or addressed in a rule proposal. Consequently, there is less need for SROs to repeatedly correct, clarify or otherwise substantiate their rule proposals if they are promulgated with public notice and comment. In the end, this process produces more precise, well-tempered, resource-efficient regulation that ultimately serves investor, industry and regulator alike.

Public notice and comment is particularly valuable within the realm of trading rules, where industry familiarity and experience are often crucial to a thorough assessment of a rule's practical implications. Because trading technology and broker-dealer automated systems have become increasingly sophisticated, ostensibly minor changes to trading practices often have far reaching ramifications beyond those initially envisioned by an SRO rule. Input and analysis from all interested parties, such as compliance, trading, systems and third party technology providers, uncover possible problems or potential consequences that may have been overlooked by an SRO rule proposal. It also allows the industry to offer alternate solutions in light of actual business practices and existing systems. By allowing for such productive dialogue prior to rule effectiveness, the current regulatory structure avoids undue effort, expense and repeated regulatory clarifications. Accordingly, SIFMA continues to believe that the scope of "non-controversial" filings under Rule 19b-4(f)(6) should be construed narrowly by the Commission.

A. Trading Rules

Although SIFMA agrees that certain SRO rule changes to trading hours generally may be submitted for immediate effectiveness, we believe the list of other examples of trading rules eligible for immediate effectiveness in the New Guidance Release is overly inclusive in several key respects. We provide below further explanations with regard to two such types of trading rules – those relating to protection of limit orders and market making, and note that similar concerns would also apply to other trading rules, including

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[10] The International Committee of the SIA (now SIFMA) issued a Discussion Paper (Promoting Fair and Transparent Regulation) in August 2000 with the intention of providing regulators with a roadmap for "best" practices for transparent regulations. Among other suggestions, the Discussion Paper stresses the importance of open and public processes. The Discussion Paper is available at http://www.sifma.org/regulatory/comment_letters/comment_letter_archives/CESR_-_Appendix.pdf.

those relating to preferenced order flow and those involving changes to conform to National Market System Plans or Commission rules.

1. Protection of Limit Orders

Under a section of the New Guidance Release labeled "Protection of Limit Orders," the Commission suggests that an SRO trading rule is eligible for immediate effectiveness if it "facilitates trading of public customer orders, or otherwise enables them to interact with order flow on the exchange on an equitable basis (such as price/time priority)." SIFMA believes that this particular guidance is overbroad because it fails to consider completely the burden imposed by such a rule on the members of such an SRO.

As noted in the Rule 19b-6 SIA Letter, FINRA's marketable limit order interpretation (NASD IM-2110-2 or the "Manning Rule"), which initially became immediately effective because it was an "interpretation" rather than a rule change, is a prime example of a limit order interpretation that created operational problems for broker-dealers by virtue of its immediate effectiveness. By treating marketable limit orders as market orders rather than limit orders, the NASD prevented such orders from continuing to "jump" from the back of the market order queue to the front of the limit order queue. While the end result was probably correct from a policy standpoint, the problem was that the firms' systems were programmed precisely the opposite way in compliance with previous interpretations. Consequently, firms were "out of compliance" as soon as this new interpretation was announced, which could have been avoided had member firms been given the opportunity to raise these issues prior to implementation. SIFMA believes that other similar SRO trading rules will produce the same types of operational issues if made immediately effective.

In addition, SIFMA is concerned about the prospect of immediately effective limit order protection rule filings that appear simple yet belie real complexity. As you may know, there has been significant industry debate between and among firms on the one hand and the NYSE and FINRA on the other hand about how best to reconcile NYSE Rule 92 and FINRA's Manning Rule. Although there has been some progress towards a reconciliation of these rules, there is not yet a final proposal after approximately 12 months of discussion. In light of the complexities being addressed in these ongoing discussions, we believe that it would be imprudent to allow immediate effectiveness for other SRO limit order protection rule filings.

2. Market Maker Obligations

SIFMA believes that any rule filing that requires market makers to make systems and operational changes, such as an adjustment to option quoting requirements for option market makers, should be subject to notice and comment requirements. It is critical that SROs consider whether new market maker obligations that appear beneficial from an

SRO's perspective (*e.g.*, as attracting volume and/or transaction revenue) also have any adverse consequences on market makers and customers.

B. Non-Trading Rules (Copycat and Minor Rule Violation Plan Changes)

Although SIFMA agrees that SRO rule changes to Minor Rule Violation Plans generally may be submitted for immediate effectiveness, we believe that certain copycat rules should not be eligible for immediate effectiveness as described in the New Guidance Release. As a general comment, SIFMA is concerned that the New Guidance Release incentivizes the SROs to submit increasingly similar rule filings at the risk that an SRO may not fully assess and address its underlying differences and unique structures in contrast to a prior rule change being copied. Examples in this regard are provided below.

1. Market Data Products and Fees

SIFMA believes that SROs in the United States are not competing with non-SRO entities, such as non-U.S. exchanges or domestic alternative trading systems or broker-dealers, to produce or distribute market data, in that each SRO, particularly the NYSE and Nasdaq, has unique data that is not possessed by any other persons.[11] In other words, rule filings regarding market data are largely insulated from the types of competitive pressures cited in the New Guidance Release as influencing the decision to grant immediate effectiveness. Therefore, given the unique nature of the market data produced by each SRO, SIFMA does not believe that market data rule filings lend themselves to effective copycatting by other SROs.

2. Sponsored and Direct Market Access Rules

Although SRO sponsored and direct market access rules may, on their face, seem very similar, SIFMA believes that such rule filings often include subtle differences that should be subjected to notice and comment. For example, recent sponsored access rule filings by the NYSE and Nasdaq have, at various times, diverged on key definitions regarding what kind of access is covered and on important components such as whether sponsored clients are required to have access agreements with the exchange.

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[11] SIFMA and others have previously addressed this issue in comment letters to the Commission. *See, e.g.*, letters dated: July 10, July 10 and October 14, 2008 by Markham C. Erickson, Executive Director and General Counsel, NetCoalition; July 10, 2008 by Ira D. Hammerman, Senior Managing Director and General Counsel, SIFMA; September 9, 2008 by Joseph Rizzello, Chief Executive Officer, National Stock Exchange; and September 11, 2008 by Bart M. Green, Chairman, and John Giesea, President & CEO, Security Traders Association. Each cited letter is available through http://www.sec.gov/comments/34-57917/34-57917.shtml.

3. Exchange Mergers and ATS or ECN Conversions to an Exchange

SIFMA does not believe that any conversion from an alternative trading system or electronic communications network to a national securities exchange should be effected without notice and public comment for the newly converted exchange's rulebook. Even if the converting entity copies verbatim the rules of an existing exchange, such rules may have subtle differences in application or consequences to members of the new exchange. On a similar note, rule filings designed to effect a consolidated rule book after the merger of two or more SROs should only be effective immediately if the prior rulebook of one of the SROs survives unchanged in its entirety for the merged SRO.

II. The New Guidance Release Should Have Been Issued for Public Comment

In the New Guidance Release, the Commission notes that the interpretive guidance therein relates solely to rule interpretations and rules relating to agency organization, procedure, or practice and, as such, is not subject to the provisions of Section 553 of the APA [5 U.S.C. § 553] requiring notice, opportunity for public comment, and publication prior to its adoption. SIFMA respectfully disagrees with that analysis. Instead, we believe that the interpretations in the New Guidance Release are sufficiently different from the guidance in the Prior Guidance Release to warrant public rulemaking and comment. Specifically, we believe that "[o]nce an agency gives its regulation an interpretation, it can only change that interpretation as it would formally modify the regulation itself: through the process of notice and comment rulemaking."[12]

In the Prior Guidance Release, the Commission noted that it would expedite the SRO rule filing process under Rule 19b-4 "only with respect to the universe of proposed rule changes that are not likely to engender adverse comments…." In the New Guidance Release, the Commission cites the Prior Guidance Release for this principle (*i.e.*, not likely to engender adverse comments) but then fails to apply it to the examples listed in the categories described therein as non-controversial. Therefore, it appears that the likelihood of receiving adverse comments may no longer be one of the criteria considered by the Commission when evaluating whether to permit immediate effectiveness. Although SIFMA recognizes that this should not necessarily be a determinative factor, we believe that it should remain a meaningful factor.

More specifically, SIFMA notes the clear change in treatment of "copycat" rule filings other than trading rules. In the Prior Guidance Release, the Commission noted that "absent unusual circumstances, filings that are virtually identical to an SRO filing already approved by the Commission will be eligible for expedited treatment…," whereas the New Guidance Release states that a proposed SRO rule may be immediately effective if "it is based on and similar to another SRO's proposed rule and each policy issue raised by the proposed rule (i) has been considered previously by the Commission … and (ii)

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[12] Paralyzed Veterans of America, *supra* note 6 *at* 586.

the rule change resolves such policy issue in a manner consistent with such prior approval."

SIFMA believes that "based on and similar to" is a substantially different threshold than "virtually identical to" a prior rule filing.[13] Although this new standard may yet prove to be appropriate, SIFMA views it as a change of interpretation that is tantamount to rulemaking by the Commission.[14]

In light of the foregoing, we urge the Commission to reconsider its guidance and return to its prior interpretation until such time that the Commission publishes for comment the modified interpretations in the New Guidance Release. Even if such notice proves not to be required under the APA, SIFMA respectfully suggests that the changes are of sufficient interest to the securities industry and the general public that useful and instructive comments would be generated by such a published notice.

If the Commission revisits the subject in the form of formal rulemaking activities, SIFMA requests that the Commission seek guidance from commenters on the following general principles:

- Implementation and testing periods should be key considerations: Any SRO rule change that requires modifications to broker-dealers' operational systems should be subject to notice and comment regardless of how similar that rule change may be to one previously approved for another SRO by the Commission. This requirement would pertain, for example, to such rules that:
  - require firms to utilize new messaging protocols;
  - require firms to change quoting sizes, increments, etc.;
  - eliminate SRO systems or functions previously relied upon by firms; or
  - allow an SRO automatically to forward orders to, or trade with, another marketplace.
- Conversely, any rule change that affects only optional activities or the use of non-essential systems by members of a particular SRO are better candidates for immediate effectiveness.

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[13] Indeed, the "absent unusual circumstances" qualifier in the Prior Guidance Release suggests that even virtually identical rule filings were not automatically eligible for immediate effectiveness under the prior guidance.

[14] It is unclear whether the Commission believes that the Prior Guidance Release was not intended to be a definitive interpretation of the non-controversial filing provisions of Rule 19b-4, in that the New Guidance Release did not explicitly state that nor effectively describe the Commission's ability to modify the Prior Guidance Release.

- Harmonization should be encouraged: The Commission should carefully balance the desire to streamline the SRO rule review process with the policy goal of harmonizing disparate SRO rulebooks. SIFMA recommends that the Commission either revert to the prior "virtually identical to" standard or add to the "based on or similar to" standard a condition stating that any discrepancies between a rule filing being submitted for immediate effectiveness and a prior rule being copied are reasonably described and justified prior to granting immediate effectiveness of such filing.

III. Unintended Consequences of the New Abrogation Process

The New Guidance Release summarily notes that the Commission rescinded the authority previously delegated to the Division for abrogation of immediately effective SRO rule filings under Section 19(b)(3)(C) of the Exchange Act.[15] Thus, only the Commission may now abrogate SRO rule filings. This change will make it extremely difficult to abrogate an immediately effective SRO rule before it becomes operative—*i.e.*, 30 *calendar* days after the date of filing or such shorter period as the Commission may designate—given the complexities in scheduling Commission action. Moreover, SIFMA is concerned that this procedural change will create undesirable "races to the Commission" in light of the new requirement that the Division publish a notice of proposed rule changes within 15 *business* days of filing.[16]

In the worst case scenario, an SRO could file an immediately effective rule filing on Wednesday, December 24, 2008. If the Division takes the full 15 business days to publish a notice, the proposal may not be issued until Friday, January 16, 2009—the day before the Martin Luther King holiday weekend.[17] Under Exchange Act Rule 19b-4(f)(6)(iii), the operative date of the proposal would be 30 calendar days after the date of filing or Friday, January 23, 2009 (unless the Commission permitted an earlier effective date). In this highly stylized hypothetical, concerned SRO members would have only three business days to seek Commission action to abrogate the rule filing. SIFMA suspects that it would be virtually impossible for the Commission to act within such a short timeframe to abrogate the proposal.[18] If an abrogation decision requires an open

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[15] SIFMA is aware of no policy reason why the Director should no longer be able to abrogate SRO rule filings, and the New Guidance Release offers no rationale for this change.

[16] This new timing provision was appended to 17 C.F.R. § 200.30-3(a)(12).

[17] This assumes that Christmas and New Year's Day are all celebrated as federal holidays when the Commission is closed. *See* 17 C.F.R. § 200.303(a)(2). If the President signs an Executive Order making Friday, December 26, 2008 a holiday for federal employees, the notice could be issued after the Martin Luther King Holiday weekend on Tuesday, January 20, 2009, or perhaps even Wednesday, January 21, 2009, if the Commission's Washington offices are closed that Tuesday for Inauguration Day.

[18] Moreover, the concerned SRO members may have as few as 33 calendar days after the notice is issued before the lapse of the potential abrogation period under Exchange Act Section 19(b)(3)(C)—*i.e.*, 60 calendar days after the date of filing—if December 26, 2008 is included among the days on which the SEC is closed.

Commission meeting, the Government in the Sunshine Act generally requires the Commission to announce its meetings one week in advance.[19] Therefore, the rule filing under this hypothetical would almost certainly be operative for some period of time before the Commission would be in a position to consider abrogation.[20]

Accordingly, SIFMA respectfully requests that the Commission either again delegate authority for abrogation to the Division Director or reconsider whether the 15 business day standard will provide enough time for SRO members to review SRO rule filings that are operative on a 30 calendar day basis (for potential abrogation or simple compliance purposes). In the alternative, the Commission might consider establishing a mechanism for the consideration of applications, on an equally streamlined and expedited basis, for emergency stays of rules in the event of exigent or unanticipated occurrences relating to rule implementation.

IV. Conclusion

SIFMA appreciates your consideration of our comments on the New Guidance Release. While we commend the Commission's efforts to improve SRO rule filing procedures, the New Guidance Release (and the related changes to the Commission's procedural rules) is fraught with difficulties and does not adequately take into account the practical implications of the proposed accelerated rulemaking. SIFMA believes that a regulator's need for flexibility must be balanced against the need for regulatory transparency, consistency and fairness. Accordingly, we strongly urge the Commission to reconsider the New Guidance Release, including whether the interpretive guidance therein should be subject to a formal public comment period before going into effect.

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[19] *See* 5 U.S.C. § 552b(e)(1).

[20] SIFMA does not believe that a request for abrogation is a suitable subject for seriatim consideration by the Commission in that such a request would likely benefit from joint deliberation by the Commissioners.

Please do not hesitate to contact the undersigned or Ann Vlcek, Managing Director and Associate General Counsel of SIFMA, at 202-962-7300 if you have any questions or would like additional information.

Respectfully submitted,

Ira D. Hammerman
Senior Managing Director and General Counsel

cc: The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
Dr. Erik R. Sirri, Director, Division of Trading and Markets
Robert L.D. Colby, Deputy Director, Division of Trading and Markets
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