

# FINANCIAL INFORMATION FORUM

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February 7, 2007

Nancy M. Morris  
Secretary, Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

RE: Financial Information Forum Comments on File Number SR-NASD-2007-002

Dear Ms. Morris:

The Financial Information Forum (FIF) welcomes the opportunity to comment on the proposed changes to NASD trade reporting to address Regulation NMS requirements. FIF ([www.fif.com](http://www.fif.com)) was formed in 1996 to provide a centralized source of information on the implementation issues that impact the financial technology industry across the order lifecycle. Our participants include trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

## **Background**

With the release of final specifications for SIP data as well as TRF specifications for trade reporting in October 2006, firms have made implementation plans to move to a 4 byte sales condition code and 1 byte trade through exempt flag by the start of the Pilot Phase. The Rule 611 Reason trade modifiers (Byte 2 of Sales Condition Field) outlined in those specifications were as follows:

- F = Intermarket Sweep (for Inbound and Outbound)
- 4 = Derivatively Priced
- Additional modifiers applicable to automated trading centers only (Opening Price, Re-opening trade, Closing Price)

The December 19 release of new CTCI NASD/Nasdaq TRF specifications and January 12 release of new FIX NASD/Nasdaq specifications include several additional trade modifiers required for trade reporting in byte 2 including:

- Intermarket Sweep Outbound (separate from Inbound)
- Self-help
- Qualified Contingent Trades
- Sub-penny trades

While implementation of any new modifier represents additional development efforts, the incorporation of the self-help modifier poses unique challenges for firms that may not be justified given other less burdensome implementation options. FIF recommends leveraging what firms are already in the process of implementing to meet NASD's surveillance requirements.

Alternatives to consider:

- Include NASD on self-help notification emails when appropriate
- Provide documentation of self-help incident reports to NASD on demand instead of, or in addition to, an optional self-help flag

### **Self Help Implementation To Date**

Rule 611 (b) (1) defines a self-help exempted trade as follows:

The transaction that constituted the trade-through was effected when the trading center displaying the protected quotation that was traded through was experiencing a failure, material delay, or malfunction of its systems or equipment.<sup>1</sup>

Much like the flickering quote exemption, the self-help exemption relates to an environmental condition affecting the marketplace as a whole. As such, automated trading centers are establishing system status notifications to communicate system problems to their membership.

Additionally, the NMS Release specifies a minimum of three elements that must be included in a trading center's policies and procedures to comply with the self-help exception: (1) notice, (2) systems assessment and response, and (3) objective parameters.<sup>2</sup>

As part of reasonable self-help policies and in accordance with the guidance laid out in the recent set of FAQs<sup>3</sup>, firms have been integrating self-help procedures into their order routing and diagnostics systems. While implementation is specific to a firm's environment, several firms have architected their systems to address self-help as part of smart order routing processes such that execution and trade reporting systems only receive quotes from active, responsive markets. In other words, these trade execution systems do not distinguish between a market that does not have a BBO because of a system problem and a market that does not have a BBO because of their current liquidity.

### **NASD Proposed Self Help Compliance - Required Trade Modifiers**

In SR-NASD-2007-002, NASD states that the purpose of the additional trade modifiers including the self-help modifier is to "ensure that there is transparency relating to trades that are exempt from the trade-through rule and to enhance NASD's ability to examine for compliance with the Order Protection Rule."<sup>4</sup>

The use of a self-help trade modifier to achieve NASD's transparency and compliance objectives is not the most desirable implementation option for several reasons.

### **Uncertain Benefit to Unplanned & Costly Development Effort**

Firms have been developing Regulation NMS compliant systems based on specifications that they understood to be final as of October 16 ("Specifications Date"). For those firms that architected their system to isolate self-help processing to market data and order routing systems, implementing self-help trade modifiers introduced at the end of December and in January will be a time-consuming and costly effort. Without substantial architectural/development changes, some firms may be forced to not implement self-help to the detriment of their customers.

Use of self-help is expected to be limited for several reasons including (1) ATCs have an affirmative obligation to address system problems appropriately and (2) the self-help modifier is only required when no other modifier applies. Given that the industry has no experience with

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<sup>1</sup> Rule 611 (b)(1), <http://www.sec.gov/rules/final/34-51808.pdf>, p. 518

<sup>2</sup> 70 FR at 37519 & n. 174, 37521-37522 & n. 194, 37535 & n. 318.

<sup>3</sup> See <http://www.sec.gov/divisions/marketreg/nmsfaq2.htm>

<sup>4</sup> See p. 16, <http://www.sec.gov/rules/sro/nasd/2007/34-55101.pdf>

self-help, undertaking extensive system changes prior to the start of the Order Protection rule may not be justified.

#### **Places Burden of Reporting Market Center Failures on Broker Dealers**

The purpose of self-help is to allow market participants to continue trading when an automated trading center is experiencing system problems. Given that the appropriate use of self-help is based on when an ATC has a problem and given the fact that ATCs are establishing system status notification, these already established procedures should be sufficient to satisfy the need for transparency. Rather than require each broker dealer to develop self-help trade reporting functionality, monitoring of ATCs system notifications would alert NASD to times when an ATC is operating in self-help mode. Trade throughs reported to NASD during that time could be evaluated accordingly.

If at all possible, it would be preferable for the pre-established SEC requirements to also fulfill NASD requirements.

#### **Potential Implementation Option - Include NASD on Self-help Email Notifications**

As stated in both the release and the FAQs, notification via email is considered a reasonable procedure for notifying market centers of an issue. This same mechanism could be used to notify NASD of a system problem. The use of email would be effective in distinguishing between a system-wide problem which should result in a large volume of emails as opposed to an individual broker-dealer problem. Significant differences in email volume would be a useful surveillance mechanism without adding implementation complexity to the process.

Use of email notifications is not without its problems, issues such as reliability, integration of order routers with email servers and other problems may arise using this type of mechanism. Additionally, with no prior experience using self-help, it is premature to conclude that real-time reporting of self help is needed.

#### **FIF Recommended Option - Provide NASD with Self-Help Documentation As Required**

As part of reasonable policies and procedures for self-help, firms expect to keep an audit trail of self-help incidents. These records would be the most complete documentation of what occurred during a self-help incident and provide the best information with which to evaluate the appropriate use of self-help. As the industry gains experience with self-help, these incident reports could be evaluated and additional reporting could be pursued. Given that this approach meets NASD's regulatory objective with a minimal implementation effort, we recommend adopting this implementation alternative.

If the self-help trade modifier remains in the specification, we recommend making it a permissive field such that firms have the option to use the self-help modifier with the understanding that trade throughs occurring as a result of self-help that are not flagged will need to be justified with documentation in the event of an examination.

#### **Implementation Timing Considerations**

The magnitude and complexity of changes associated with implementing Rule 611 and the new ATC functionality should not be underestimated. If the implementation alternatives identified are not sufficient to meet NASD's regulatory needs, we respectfully request additional time to implement the new NASD modifiers that were added after the Final Specifications Date of October 16, 2006. Moving the compliance date for the new NASD trade modifiers to the "Completion Date" of October 8 would give firms the opportunity to implement the modifiers and

allow the industry to gain experience with Reg NMS changes generally and self-help in particular.

In summary, we hope that you consider the outlined alternatives to the use of the self-help trade modifier with the goal of achieving a reasonable balance between regulatory objectives and implementation costs.

Regards,

A handwritten signature in cursive script that reads "Manisha Kimmel".

Manisha Kimmel  
Executive Director, Financial Information Forum  
on behalf of the FIF Regulation NMS Working Group