

VIA ELECTRONIC MAIL

July 8, 2013

Elizabeth M. Murphy
Secretary
Securities Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Proposed Regulation Systems Compliance and Integrity

Dear Ms. Murphy:

On March 8, 2013, the Securities and Exchange Commission (SEC) released proposed Regulation Systems Compliance and Integrity (Regulation SCI),¹ requesting comment on a comprehensive set of new requirements for certain regulated entities' automated systems. Regulation SCI would require certain entities to establish written policies and procedures designed to ensure the resiliency and operational capacity of their systems and require additional reporting and testing. In addition, Regulation SCI requires certain entities to implement new books and records procedures and modifies the volume thresholds in Regulation ATS. The Financial Services Institute² (FSI) appreciates the opportunity to comment on this important proposal.

Background on FSI Members

The independent broker-dealer (IBD) community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisers are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 independent financial advisers – or approximately 64% percent of all practicing registered representatives – operate in the IBD channel.³ These financial advisers are self-

¹ Release 34-69077, 78 Fed. Reg. 18,083, available at <http://www.sec.gov/rules/proposed/2013/34-69077.pdf>.

² The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 100 Broker-Dealer member firms that have more than 138,000 affiliated registered representatives serving more than 14 million American households. FSI also has more than 35,000 Financial Advisor members.

³ Cerulli Associates at <http://www.cerulli.com/>.

employed independent contractors, rather than employees of the IBD firms. These financial advisers provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisers are typically “main street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market of advisers affiliated with IBDs is comprised of clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisers are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.⁴ Independent financial advisers get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisers have a strong incentive to make the achievement of their clients’ investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisers. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisers play in helping Americans plan for and achieve their financial goals. FSI’s primary goal is to ensure our members operate in a regulatory environment that is fair and balanced. FSI’s advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

Comments

Regulation SCI has been created as a result of the increased use of sophisticated automated systems in the financial markets, as well as recent events highlighting trading and stability issues. The so-called “Flash Crash” on May 6, 2010⁵ was one such event that demonstrated systems-related issues that may result from fully automated trading strategies and systems. The trading system issue encountered by NASDAQ during the Facebook, Inc. IPO on May 18, 2012⁶ is another example of systems-related issues in the financial markets. More recently, the systems outage that shut down the Chicago Board Options Exchange (CBOE)⁷ on April 25, 2013, provides another example indicating that technological disruption in the financial markets poses a risk to investors. Regulation SCI aims to address system-related issues through a complex and comprehensive set of additional requirements on a specific set of entities referred to as SCI Entities.⁸ These entities, which include self-regulatory agencies (SRO), alternative trading systems (ATS), and exempt clearing agencies subject to the automation review policy (ARP), would face significant systems compliance requirements that aim to ensure more robust reporting, review, and corrective action

⁴ These “centers of influence” may include lawyers, accountants, human resources managers, or other trusted advisers.

⁵ See Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues, “Findings Regarding the Market Events of May 6, 2010” (September 30, 2010), available at <http://www.sec.gov/news/studies/2010/marketevents-report.pdf>.

⁶ Securities and Exchange Commission, “SEC Charges NASDAQ for Failures During Facebook IPO,” available at <http://www.sec.gov/news/press/2013/2013-95.htm>.

⁷ Chicago Board Options Exchange, “CBOE Holdings Statement on Today’s Trading Issue” (April 25, 2013), available at <http://ir.cboe.com/releasedetail.cfm?ReleaseID=759476>.

⁸ Regulation Systems Compliance and Integrity, 78 Fed. Reg. at 18,091.

related to technology systems. FSI continues to support regulatory efforts that aim to protect the stability and efficiency of financial markets. While FSI's members, generally, do not fall under the definition of SCI entities, many of the provisions included in Regulation SCI will have an effect on their activities and businesses. In addition, retail clients in the financial markets should not be left with the perception that technological issues pose a risk to their long-term financial futures. Regulation SCI, therefore, must maintain the fair and orderly activity of markets in order to facilitate investor confidence in financial markets at the lowest possible cost to investors. We expand on these comments below.

- **Broker-Dealers Other Than SCI ATs Should Not Be Included as SCI Entities** - The proposed Regulation SCI solicits comments regarding the potential inclusion of additional market participants not currently covered under the definition of SCI Entities. FSI strongly opposes the inclusion of broker-dealers to the definition of SCI Entities. Broker-dealers that execute securities trades, even large multi-service broker dealers engaging in a variety of order handling, trading, and clearing activities, are already subject to very high standards of systems compliance and integrity required by Financial Industry Regulatory Authority (FINRA) regulations and state laws.⁹ Firms who do not maintain sufficient protection of customer data and supervisory policies are subject to disciplinary action. In addition, broker-dealer firms conducting activities on behalf of retail clients should not be subject to additional requirements (and the corresponding costs associated with implementing new requirements) if potential problems can be solved through additional regulation on the current set of SCI entities included in the proposal. Additional regulation should be included only after comprehensive and robust cost-benefit analysis that implements new requirements at the lowest possible cost to firms and investors. Regulation SCI's additional requirements imposed on broker-dealers are unnecessary for achieving the SEC's goals, and would raise costs on investors.
- **Regulation SCI Must Address Perceptions of Financial Market Instability to Restore Investor Confidence** – Technology related market events, such as the May 6, 2010 “Flash Crash” and the more recent trading disruption of the CBOE, may give retail investors the impression that financial markets are unstable. In addition, recent press reports describing low-latency data feeds which allowed certain firms to trade on information prior to its availability to the wider market¹⁰ further erode investors' trust in the integrity and fairness of financial markets. This, in turn, destroys confidence in the benefits of investing and the importance of impartial and competent financial advice. Restoring confidence in the fair and orderly functioning of financial markets must be at the forefront of the SEC's attention, and Regulation SCI must address this issue by ensuring that technological failures do not result in disruption. With the widespread attention of algorithmic and high-speed trading occurring on public exchanges, the SEC should also take additional steps to study the effects that these activities have for retail investors. The SEC should also strengthen its own market surveillance and enforcement activities to ensure that the increased use of technology in the financial markets does not violate SRO and SEC regulations. Activities done by a human

⁹ See, e.g., FINRA Rule 3010 (Supervision); Regulation S-P, Privacy of Consumer Financial Information, 17 C.F.R. § 248; Commonwealth of Massachusetts General Law Chapter 93H (implemented by 201 C.M.R. 17.00).

¹⁰ Eamon Javers, “Unraveling Monday's Early Data Release to Traders”, CNBC.com (June 5, 2013), available at <http://www.cnbc.com/id/100792260>.

trader that would violate regulations should not be tolerated by high-speed trading algorithms, and the SEC and SROs should dedicate additional resources for identifying and counteracting any potential abuses.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with the SEC on this and other important regulatory efforts.

Thank you for your consideration of our comments. Should you have any questions, please contact me at



Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. T. Bellaire".

David T. Bellaire, Esq.
Executive Vice President & General Counsel