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July 22, 2013

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

Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

Re: File No. S7-01-13; Proposed Regulation Systems Compliance and Integrity

Dear Ms. Murphy:

LiquidPoint LLC (“LiquidPoint”) appreciates the opportunity to provide the Securities and Exchange Commission (“Commission” or “SEC”) with comments regarding proposed Regulation Systems Compliance and Integrity, also known as proposed “Regulation SCI.”

**Introduction**

LiquidPoint is a registered broker-dealer that, among other things, trades in options on national options exchanges. LiquidPoint recognizes the need “to ensure the capacity, integrity, resiliency, availability, and security, and enhance compliance with federal securities laws and regulations, of automated systems relating to the U.S. securities markets” – part of the Commission’s stated purpose of Regulation SCI. However, LiquidPoint believes that Regulation SCI should focus more on the markets as a whole, and take into account the relative degrees of risk to the markets posed by “SCI entities” and by “SCI systems”. Depending upon the market participant, certain functions and systems used are more critical to the effective operation of the markets than are others. Similarly, some SCI events are of more urgency than others. The proposed regulation does not recognize these facts and, instead, provides a “one-size-fits-all” approach with respect to the definitions and obligations of SCI entities. Also, SCI systems are not categorized based upon the degree to which systems are critical or pose substantial risks to the markets. With this understanding, LiquidPoint respectfully suggests that Regulation SCI should instead be constructed as a “principles-based” approach to allow for effective implementation.

Additionally, and of particular concern to LiquidPoint, is the continuing lack of clarity regarding the applicability of certain aspects of Regulation SCI to listed-options facilities. LiquidPoint operates the listed-option pairing facility known to the Commission as “LiquidPoint NXP” (“NXP”). NXP pairs options orders from LiquidPoint customers for

submission to the automated auction process on a registered options exchange, and any executions that occur with respect to that pairing take place solely on the exchange pursuant to the auction rules of the exchange. As you are aware, despite the fact that LiquidPoint does not believe that NXP meets the definition of either an “exchange” or an alternative trading system (“ATS”) under the Securities Exchange Act of 1934, as amended (“Exchange Act”), NXP was required to register with the Commission as an ATS.<sup>1</sup> As such, NXP could potentially be subject to the requirements of Regulation SCI as an SCI entity, despite the fact that the Commission’s discussion of ATSS in the Regulation SCI proposing release does not appear to make sense when applied to NXP.

### **SCI Entities**

#### ***Principles-based approach vs. Rule-based “One-Size-Fits-All” approach will be more effective***

Regulation SCI defines “SCI entities” and would apply uniform requirements on all such entities. The Commission should recognize that different SCI entities play different roles in the functioning of the capital markets. Those posing greater risks to the market as a whole, such as a market data distributor, primary listing exchange or a clearing agency, should have greater obligations than non-primary exchanges or a single ATS. As such, the Commission should adopt a principles-based approach founded upon the relative risk to the markets when considering the SCI entity obligations under the regulation.

### **SCI Alternative Trading Systems**

The proposed regulation defines an SCI alternative trading system (“SCI ATS”) using thresholds with respect to NMS stocks, “equity securities that are not NMS stocks”, and fixed income securities. Whether an ATS trading in such non-NMS stocks is an “SCI ATS” for purposes of Regulation SCI would depend on whether (i) transactions in those instruments are reported to an SRO, and (ii) whether the ATS has met the volume threshold of five percent (5%) or more of the average daily dollar volume in that non-NMS stock. Though listed options on equity securities could be “equity securities that are not NMS stocks”, there is no reference to trading volume thresholds for listed options in the proposed definition of SCI ATS, and the proposed flat 5% trading volume threshold for non-NMS stocks does not make sense in the listed options context, where there are multiple options classes with varying expiration dates relative to each underlying equity security.

Nevertheless, even if the proposed definition of SCI ATS were to be amended to include an appropriately configured volume threshold for listed options trading, LiquidPoint believes that

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<sup>1</sup> In fact, LiquidPoint believes that its NXP system is the only such pairing system that has been required by the SEC staff to register as an ATS. LiquidPoint believes the additional burden that would be placed on it if NXP were to be considered a SCI ATS at the very least warrants a review of the ATS designation.

relative risk is the best metric for determining what should be deemed an SCI entity – not trading volume. As SIFMA has opined in its comments on proposed Regulation SCI:

Under this [risk-based] approach, any obligations under Reg. SCI would depend solely on the function performed by an ATS rather than on whether an ATS met a given volume threshold. As noted, for example, an ATS that directly affects the public quotation stream might reasonably be deemed more critical than a marketplace that is responsible for the function of providing non-displayed liquidity. Similarly, an ATS that is not responsible for the primary price-setting function for NMS securities should only be obligated to adhere to the requirements for a low to medium criticality function.

While LiquidPoint supports this risk-based approach to defining an SCI ATS, it also notes that it is based upon the equity trading model, not the listed-options trading model, where all executions occur only on a registered options exchange. Certainly, pairing orders for auction on a listed-options exchange, which is what NXP does, is not a price-setting function of NMS securities and does not have any critical effect upon the national market system.

Consequently, LiquidPoint believes that the Commission should make clear that listed-options ATSS, to the extent that the Commission continues to assert that they exist, are excepted from the definition of “SCI ATS” and therefore from the requirements of Regulation SCI.

#### *Additional comments*

In general support of SIFMA’s comments on the proposed Regulation SCI, LiquidPoint believes:

- The requirements for policies and procedures, notification of events to Commission staff, advance notification of systems changes, and annual review of systems should depend upon the degree to which an SCI entity impacts the markets.
- The separate definition of an “SCI security system” and its related requirements is an artificial construct that is not necessary and should be eliminated. The general requirement related to the security of SCI systems would be sufficient.
- The requirement to provide the Commission advance notification of material changes to SCI systems is too all-encompassing and will inhibit the ability of an SCI entity to implement changes to its systems in a timely manner.
- The Commission should recognize that, despite best efforts, SCI entities will experience systems problems on occasion regardless of Regulation SCI’s

adoption. In fact, the Commission has previously acknowledged that it is not possible to prevent every technological error.<sup>2</sup> The focus of the regulation should be on the reasonableness and application of an SCI entity's policies and procedures and not punishing simply for experiencing a systems issue.

- Regulation SCI should not be expanded to all broker-dealers. Many broker-dealers' functions have no systemic impact on the national market system and are already subject to numerous regulations requiring the establishment of controls, including the Market Access Rule.
- The proposal that SCI entities provide Commission representatives direct onsite or remote access to SCI systems adds security risks and will likely not be useful to the Commission.
- Requiring corrective action by SCI personnel upon becoming aware of an SCI event undermines the internal escalation policies and procedures of SCI entities designed to analyze and determine the best course of action during a complex SCI event.
- Business continuity and disaster recovery plan testing for SCI entities and their members/participants presents significant technological and logistical challenges.

### **Summary**

LiquidPoint appreciates the need for capacity, integrity, resiliency, availability and security of key automated systems of those entities of particular importance to the national market system. The implementation of Rule SCI will be most effective, however, if the Commission crafts a principles-based approach founded on the relative risk of SCI entities and SCI systems to the national market system. An inflexible rule-based approach will be less cost-effective, divert resources from most critical systems, reduce technological innovation, impair competitiveness and hinder effective compliance and oversight.

Additionally, the current proposal does not contemplate the application of the regulation to a listed-options ATS, such as LiquidPoint's NXP. Moreover, LiquidPoint continues to believe that NXP is not, in fact, an ATS or exchange under the Exchange Act. Accordingly, the Commission should except listed-options ATSS, including NXP and other similar ATS (if they

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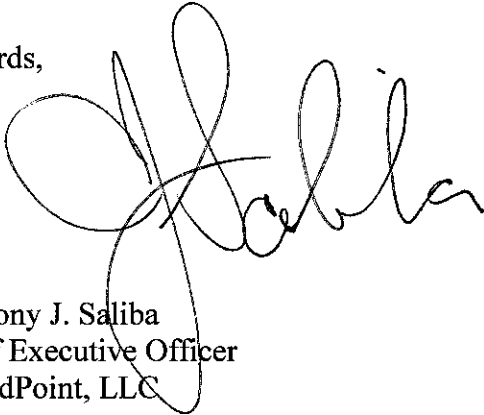
<sup>2</sup> Chairman Elisse Walter recognized that technological errors by market participants inevitably happen. She stated, "[w]hile it is not possible to prevent every technological error each market participant may commit, as the overseer of our securities markets it is the Commission's responsibility to ensure that our regulations are designed to minimize their impact on our markets and ultimately investors.", Securities and Exchange Commission, *Chairman Elisse Walter's Opening Statement at the SEC Open Meeting*, available at, <http://www.sec.gov/News/Speech/Detail/Speech/1365171515104>.

LiquidPoint, LLC Comment  
Regulation SCI  
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exist), from the definition of SCI entity and the application of Regulation SCI.

Should you have any questions, please do not hesitate to contact me at (312) 986-2006 or [ajs@liquidpoint.com](mailto:ajs@liquidpoint.com).

Regards,

A handwritten signature in black ink, appearing to read 'Anthony J. Saliba', written in a cursive style.

Anthony J. Saliba  
Chief Executive Officer  
LiquidPoint, LLC

cc: Mary Jo White, Chairman  
Elisse B. Walter, Commissioner  
Luis A. Aguilar, Commissioner  
Troy A. Paredes, Commissioner  
Daniel M. Gallagher, Commissioner

John Ramsay, Acting Director, Division of  
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