



## asset management group

June 13, 2023

Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

**Re: Supplemental Information and Reopening of Comment Period for Amendments to Exchange Act Rule 3b-16 Regarding the Definition of “Exchange” (File No. S7-02-22)**

Dear Ms. Countryman:

The Asset Management Group of the Securities Industry and Financial Markets Association (“**SIFMA AMG**”)<sup>1</sup> appreciates the opportunity to provide comments to the Securities and Exchange Commission (the “**Commission**” or “**SEC**”) on the above-referenced release (the “**Reopening Release**”)<sup>2</sup> that provides supplemental information and reopens the comment period for the Commission’s January 2022 proposal to amend Rule 3b-16 and Regulation ATS (the “**Proposal**”).<sup>3</sup>

### Overview:

As stated in SIFMA AMG’s initial comment letter submitted on April 18, 2022 (“**SIFMA AMG Letter I**”)<sup>4</sup>, the Proposal makes a number of changes to an existing regulation that has functioned very well. In our view, the broad drafting of the Proposal, even as clarified in the Reopening Release, suggests a dramatic expansion of regulatory scope and obligations – in

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<sup>1</sup> SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG’s members represent U.S. and global asset management firms whose combined assets under management exceed \$45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

<sup>2</sup> *Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of “Exchange,”* Exchange Act Release No. 97309 (April 14, 2023), 88 Fed. Reg. 29448 (May 5, 2023), available at <https://www.govinfo.gov/content/pkg/FR-2023-05-05/pdf/2023-08544.pdf>

<sup>3</sup> *Amendments to Exchange Act Rule 3b-16 Regarding the Definition of “Exchange” and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities,* Exchange Act Release No. 94062 (Jan. 26, 2022), 87 Fed. Reg. 15496 (Mar. 18, 2022), available at <https://www.govinfo.gov/content/pkg/FR-2022-03-18/pdf/2022-01975.pdf>.

<sup>4</sup> Letter from Lindsey Weber Keljo, Acting Head, and William C. Thum, Managing Director and Assistant General Counsel, SIFMA AMG, to Vanessa A. Countryman, Secretary, SEC, on the Proposal (April 18, 2022), available at <https://www.sec.gov/comments/s7-02-22/s70222-20124028-280153.pdf>.

ways unrelated to a data-driven identification of problems requiring attention. And it is the risk of such an expansion of scope and obligations that presents the most troubling consequences.

The wording of the Proposal, perhaps intended to capture a limited number of alternative trading systems, risks being interpreted to extend to a host of systems either developed by vendors or in-house to facilitate efficiencies and cost savings but that have no market trading capabilities.

In response to the Reopening Release, we appreciate the Commission's confirmation the Proposal was not targeting OEMSs and ETF portals in the proposed expansion of the definition of "Exchange" and the suggested edits intended to narrow the scope of certain defined terms. That being said, we are not convinced the proposed wordsmithing provides adequate clarification to avoid the potential capturing of such systems. For this reason, we strongly recommend that OEMS systems as well as ETF portals be explicitly carved out from treatment as an "Exchange".

In addition, if the Commission moves forward with the Proposal, it is critical to clearly define the term "non-discretionary" – both in terms of who sets the standards and what the standards address. At the most basic level, we believe "non-discretionary" should relate to protocols set by the system operator that determine the scope of parties with whom users may interact as well as the scope of information users may observe. Such clarifications will help to avoid capturing systems customizable by individual users to achieve efficiency in order management.

### **Executive Summary**

The approach in our letter can be summarized as follows:

- I. **"Non-discretionary" must be clearly defined as being key to the definition of an "Exchange".** "Exchange" treatment must not apply if the user has discretion: (1) to select potential counterparties and (2) to select the preferred order/response.
- II. **Proposed amendments are insufficient to narrow the scope of the systems intended for "Exchange" treatment.** While terms like "establishes" and "negotiation protocols" appear more likely to be interpreted as closer to the mark, there remains too high a degree of ambiguity, and this drafting exercise avoids the most critical issue - the need to provide certainty for the use of the term "non-discretionary."
- III. **OEMS systems and ETF portals lack key components of an "Exchange".** OEMS and ETF portal systems have been carefully developed by a diverse group of market participants to introduce efficiencies and cost savings into the market – but do not allow for separate users to interact and do not directly connect with multiple brokers to confirm the non-discretionary execution of orders.

- IV. **Explicitly carve out OEMS systems and ETF portals from treatment as an “Exchange”.** Not only would this avoid the risk that such systems could ultimately be found to qualify for “exchange” treatment, but almost more importantly such a carve-out would eliminate any risk of developers abandoning innovations designed to achieve greater efficiencies and cost-savings for the benefit of investors.

## Discussion

I. **“Non-discretionary” must be clearly defined as being key to the definition of an “Exchange”.**

SIFMA AMG supports the Commission’s intention to expand the range of systems requiring treatment as an “exchange” or ATS so that market participants that are subject to trading rules of a third-party operator can avail themselves of the same investor protections, fair and orderly market principles, and SEC oversight that apply to registered exchanges and ATSs. And, generally, we also recognize that certain systems where multiple buyers and sellers are able to interact on discrete bids and offers, and orders may be executed may qualify for ATS treatment.

Systems developed to match orders for securities should be regulated as “exchanges” especially as problems with such systems may negatively impact pools of market liquidity that are non-fungible with alternative trade-execution systems. We believe the Commission has appropriately targeted systems where the operator has set “non-discretionary” rules that permit all users of the system to view and match with each other’s trading interests. These operator-set “non-discretionary” protocols are critical for exchange-like outcomes as orders can be automatically matched between buyers and sellers.

Our members are concerned that the Proposal’s existing description of “non-discretionary” system methodology could capture systems exhibiting established processes, whether manual or automated, other than operator-set limits on with whom users may interact and what information user’s may experience. Moreover, our members are concerned that industry standard messaging protocols (e.g., FIX messaging protocols) would be considered non-discretionary parameters. The Commission should clarify that “non-discretionary” protocols does not mean standardized message fields such as security name, price, size, or direction.

While the Commission has clarified that it excludes systems from “exchange” treatment where the broker-dealer operator applies “its discretion in matching counterparties on the system,” it also states that if a system includes “the ability of the system operator to apply its discretion for handling trading interest, these activities employing discretion by the system operator would be within the meaning of a system that meets the criteria of Rule 3b–16(a).”<sup>5</sup> The different treatment confirms the ambiguity of the Commission’s assessment as it treats discretion

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<sup>5</sup> Proposal at n.113

in matching orders as not requiring “exchange” treatment while it finds discretion in handling trading interest (whatever that means) to qualify for “exchange” treatment.

We worry that the concept of operator “discretion” could be found to include any form of system automation, which necessarily requires programming and sequencing of operations. It is for this reason that we perceive the Proposal to have presented far too broad a view of the scope of non-discretionary methods and, in so doing, strongly discourages the greater efficiencies achievable through automation of processes to find trading counterparties.

SIFMA AMG believes that a system that: (a) provides a user with discretion as to who to interact with from among counterparties with which it has a pre-existing relationship; and (b) provides the user with discretion to choose from among orders/responses from those selected counterparties (e.g., the system does not require a match against the best response), should not be viewed as having established “non-discretionary methods” through which orders/trading interest interact. A final rule must clarify that such systems do not qualify for “exchange” treatment.

As noted above, “exchange” treatment must not apply if the user has discretion: (1) to select potential counterparties and (2) to select the preferred order/response. Exchanges do not allow for this type of discretion. Rather, the hallmark of an exchange is that a user submitting an order may not choose either its counterparty or the order with which it interacts. The mere automation of these forms of discretion should not render such a system an exchange.

SIFMA AMG strongly urges the Commission to revise the meaning and scope of “non-discretionary” methods consistent with the above recommendations and to provide concrete examples related thereto.

## **II. Proposed amendments are insufficient to narrow the scope of the systems intended for “Exchange” treatment.**

SIFMA AMG appreciates the Commission’s efforts to provide additional clarity with respect to the Proposal. In response to comments received on the Proposal, the Commission has proposed several variations to the text of Rule 3b-16 through its questions. And while our members perceive that the Commission’s intent appears to be to narrow the definition of “exchange” to more clearly describe its intended target, in presenting numerous options in the questions, it is now unclear exactly what the Commission is actually proposing.

For example, in Question 10 of the Reopening Release, the Commission asks whether it should adopt alternative language to “makes available,” and whether the addition of the phrase “directly or indirectly” would focus the rule text on a function that a party performs in the provision of an established, non-discretionary method to bring together buyers and sellers.

To clarify the target is operators of systems, in Question 11, the Commission proposes to remove the term “uses” and insert the term “makes available” before “established, non-

discretionary methods.” The Commission also notes that “communication protocols” would be in addition to a “trading facility.” The Commission next asks whether, alternatively, instead of using the terms “uses” and “makes available”, it should adopt amendments to Exchange Act Rule 3b-16(a)(2) that state “[E]stablishes non-discretionary methods (whether by providing, directly or indirectly, a trading facility or...)”

While Question 12 queries whether the term “communication protocols” is an appropriate addition to the focus on “trading facilities”, Question 13 asks if the term “negotiation protocols” should be substituted for “communication protocols” and describes “negotiation protocols” as a nondiscretionary method that sets requirements or limitations designed for multiple buyers and sellers of securities using trading interest to interact and negotiate terms of a trade.

In our experience, the Commission should avoid altogether the use of terms such as “communication protocols” as being effectively a generic description in the market for a host of systems. They are characterized as low-level technical protocols for communicating electronic messages to the markets. Such protocols are typically termed ‘communication protocols’ or ‘messaging protocols’ – for example, FIX (Financial Information eXchange) or REST (REpresentational State Transfer) are protocols that are employed via programmatic APIs (Application Programmer Interfaces). It is precisely the technical terms ‘communication protocol’ and ‘messaging protocol’ that are proper to the realm of the low-level technical specifics of internal or third-party OEMS systems and that unhelpfully conflate with SEC’s proposed use of the term “communication protocols” and could therefore be inappropriately interpreted as falling in scope for treatment as an “exchange.”

SIFMA AMG appreciates the Commission’s efforts to propose more precise drafting. However, while terms like “establishes” and “negotiation protocols” appear more likely to be interpreted as closer to the mark, there remains too high a degree of ambiguity, and this drafting exercise avoids the most critical issue - the need to provide certainty for the use of the term “non-discretionary.”

As noted above, the focus must be on order-matching systems where the user has no discretion as to with whom a trade is matched or to the terms of trades capable of being matched. The terms “uses” and “makes available” could inappropriately force those not setting non-discretionary limits to register as an “exchange”, while the term “communication protocol” could capture most, if not all, means of communication. For the phrase “negotiation protocol” to be useful for these purposes there is the need to clarify that “protocol” means operator-set discretionary limits on who can participate in pre-defined orders. In both cases, without first clarifying “non-discretionary” there is a significant risk of capturing mere messaging services.

### **III. OEMS systems and ETF portals lack key components of an “Exchange”.**

SIFMA AMG believes that in expanding the definition of “exchange” and adding the term “communication protocols” in the Proposal, the Commission risks moving too far beyond

trading venues and is potentially capturing a broad range of OEMS and ETF portal systems carefully developed by a diverse group of market participants to introduce efficiencies and cost savings into the market – but which do not allow for separate users to interact and do not directly connect with multiple brokers to confirm the non-discretionary execution of orders.

Such systems do not present the level of operational risk or investor protection concerns requiring the same degree of regulatory oversight applied to the existing 24 national securities exchanges, 50 regulated equity trading venues, and 34 ATSS, as such OEMS and ETF portal systems do not perform functions traditionally associated with exchange activity such as the interaction of bids and offers and the matching or crossing of orders.

**a. OMS/OEMS System Uses and Characteristics.**

Among other functions, a single user (e.g., an asset manager) would use an OEMS to identify liquidity in different marketplaces, monitor real-time market conditions, and route and organize orders to marketplaces. OEMSs allow advisers to manage investments more efficiently, enhance fund pricing practices, and reduce overall transaction costs and trading frictions, thereby enhancing the ability to attain best execution on behalf of funds and their investors.

While such systems facilitate communications from users to broker-dealers, they are not “platforms” on which multiple buyers and multiple sellers interact with each other for price discovery or otherwise. Absent extraordinary facts, neither an “exchange” nor a communication protocol should be inferred from the interactions of separate systems in the absence of a unified single system for buyers and sellers to interact with bids and offers. Non-discretionary parameters should not be inferred unless the system imposes rules on both parties as to how the parties must transact with each other.

Components of internal or third-party OMS/OEMS systems developed to process orders and/or execution are as follows:

1. Facilitate communication of trading interest by connecting a single end-user to a liquidity source such as a trading venue, exchange, ATS, OTC or an exchange market-maker, futures or options market, broker, dealer, or bank *i.e.*, providing a communications link and conveying trading instructions to such liquidity sources via an OEMS.
2. Import and display data fields or information from connected liquidity sources, *e.g.*, facilitating submitting requests-for-quotes (RFQs) or receipt of indications of interest (IOIs), including from multiple broker-dealers, based on the methods, rules, or protocols set forth by those liquidity sources, including industry-standard message fields.

3. Apply protocols that are established by the connected liquidity sources or the single firm that is using the OEMS (*e.g.*, the counterparties to which trading interest is visible, minimum sizes for transactions, time periods for responses, and counterparty credit limits). To the extent that the OEMS is provided by a third-party vendor to a single end-user, the third-party vendor does not impose non-discretionary protocols on how such end-user transacts, and any such protocols are developed by the end-user and the liquidity sources to which it connects. When communicating trading interests to a customer via the customer's OEMS, the liquidity source maintains discretion over exactly which customer can see and can respond to such trading interest and can display different trading interests to different customers; the OEMS does not aggregate and redistribute trading interests to all its customers.
4. Organize, present, or otherwise display trading interest (whether firm or non-firm) that is available at connected liquidity sources in a user-friendly format.

Such systems lack system-imposed protocols for all buyers and sellers as to hours of operation, order or response timing requirements, error or trade dispute resolutions mechanisms, or similar rules customary for "exchanges." Such systems have presented no evidence of issues raising investor protection concerns but add significant efficiencies and cost savings in the management of customer assets.

#### **b. ETF Portal Uses and Characteristics.**

ETF creation and redemption portals are web-based systems through which Authorized Participants ("APs") may communicate creation and redemption requests for ETFs. The portals offer a convenient and efficient means for such requests to be communicated by APs to sponsors. Sponsors may post information and incorporate tools on such portals which help APs to request custom baskets for ETF creation requests, primarily for fixed-income ETFs.

For example, in connection with fixed income ETFs where it is not possible or practical for an AP to deliver a pro-rata portion of each bond in the ETF, the ETF sponsor may publish a target list of bonds on the portal to indicate the subset of bonds it would likely accept for a creation request. A sponsor's portal would typically cover all ETFs offered by the ETF sponsor and only registered broker-dealers who have signed up as an AP for a particular ETF would be allowed to place an order to create or redeem shares for that ETF. Entities that are not registered broker-dealers would not have access to the portal.

We do not believe the Commission intended to capture such portals as exchanges, but given the breadth of the current definition, it is possible these portals could be classified as exchanges. We do not believe there would be any public benefit to treating such portals as exchanges and requiring registration as an ATS. The only entities permitted on the portal (other than the ETF issuers) would be registered broker-dealers. We do not see any public policy,

consumer protection or level playing field benefit to having the portal operator register as a broker-dealer under these circumstances.

Likewise, ATS recordkeeping and Form ATS-R reporting requirements would be duplicative and an incremental unnecessary burden as creation and redemption activity by an ETF is already publicly available. While such portals may qualify for the new proposed exemption for an issuer to sell its own securities to investors under 3b-16(b)(3), it is not clear on its face that this exemption would cover a portal on which multiple issuers offer securities.

Where the issuers are all investment funds offered by the same sponsoring entity (including affiliates), we believe there would be no public policy reason for the exemption not to apply. If each ETF could establish its own portal and avail itself of the exemption, it seems odd that a sponsor would not be allowed to create a single portal for all such ETFs. However, as these portals allow both creation and redemption requests, the proposed 3b-16(b)(3) exemption may not be available in connection with the portal's redemption (repurchase) activity.

#### **IV. Explicitly carve out OEMS systems and ETF portals from treatment as an "Exchange".**

We appreciate that in the Reopening Release the Commission clarified that it did not intend to capture OEMSs or ETF portals in the proposed expanded definition of an "exchange." And for the reasons specified above we believe such systems may be interpreted as falling outside the proposed "exchange" definition.

Nevertheless, to provide certainty to market participants, we believe the most prudent approach would be to explicitly carve out OEMS and ETF portals from the definition. Not only would this avoid the risk that such systems could ultimately be found to qualify for "exchange" treatment, but almost more importantly such a carve-out would eliminate any risk of developers abandoning innovations designed to achieve greater efficiencies and cost-savings for the benefit of investors.

The Commission has explicitly questioned the need to adopt an exclusion that applies only to ETF portals that fall within this definition: "a system that allows one or more issuers from the same sponsoring entity to solicit creation or redemption requests for their own securities submitted by authorized participants for those securities." In general, we agree with this definition with two recommended changes. First, as the focus is on "issuers" and such systems could cover each of ETFs and ETPs (e.g., exchange-traded products), we recommend the exclusion should reference "issuer portals" rather than "ETF Portals." Second, the phrase "from the same sponsoring entity" is not appropriate as many such portals are operated by third parties and permit participation by multiple sponsors (although no ETF is permitted to transact with another ETF).



**Conclusion**

SIFMA AMG appreciates the Commission's intent to support the well-functioning of our markets, but absent the clear identification of a problem not already well-addressed by existing regulations, we have serious questions and concerns about the potential for an expansive interpretation as to the scope of these changes. Our members, each representing retail investors, highly value the OMS / OEMS systems which do not allow the interaction of buyers and sellers for price discovery or otherwise. We are concerned that the current drafting could sacrifice value-adding management systems which present no identified risk, and thereby sacrifice the efficiencies and cost savings presently enjoyed by investors as a result of the use of such systems.

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On behalf of SIFMA AMG, we appreciate the opportunity to respond to the Reopening Release and your consideration of our comments and recommendations. If you have any questions or require additional information, please do not hesitate to contact us by calling William Thum at (202) 962-7381.

Sincerely,



William C. Thum  
Managing Director and Assistant General Counsel

cc: The Honorable Gary Gensler, Chair  
The Hon. Hester M. Peirce, Commissioner  
The Hon. Caroline A. Crenshaw, Commissioner  
The Hon. Mark T. Uyeda, Commissioner  
The Hon. Jamie Lizárraga, Commissioner