sifma asset management group

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June 28, 2024

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**")[1] and SIFMA[2] appreciate the opportunity to provide additional comments to the Securities and Exchange Commission (the "**Commission**" or "**SEC**") on the above-referenced release (the "**Reopening Release**")[3] 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**").[4]

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[1] 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.

[2] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[3] *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.

[4] *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.

Overview

As stated in previous comment letters submitted by SIFMA AMG[5] and SIFMA,[6] the Proposal seeks to make a number of changes to an existing regulation that has functioned to serve its statutory purpose very well for many years, and which was carefully tailored to respond to the particularities of the activities it sought to regulate. In our view, the imprecise drafting of the Proposal, even as elaborated upon in the Reopening Release, applies a significant – and yet to be fully explained or justified – expansion of regulatory scope and obligations in a manner unrelated to an identified problem within the statutory remit of the Commission.

The Proposal would overlay a highly prescriptive regulatory framework onto a host of activities that bear little resemblance to commonly understood exchange-like activities. Without identifying a clear purpose or benefit to investors or the market, there is a significant risk of inflicting an irreparable setback to decades of advancement in improving market efficiencies and reducing operational risk through technological innovation. We therefore ask the Commission to work with market participants to craft a re-proposed rulemaking that adheres to the statutory purpose of exchange regulation set forth by Congress and tailors the regulatory regime to the specific risks posed by yet-to-be-identified systems that should be characterized as "exchanges."

Executive Summary

The approach in our letter can be summarized as follows:

I. **The Commission should move forward with a re-proposal coupled with a thorough cost-benefit analysis**. The Commission should not proceed with the Proposal as currently drafted given the wide range of unrelated beneficial activities potentially captured under the Proposal and the lack of adequate cost-benefit analysis conducted with respect to such activities.

II. **In any re-proposal, the Commission should explicitly clarify the scope of systems subject to Reg ATS including specific carve-outs consistent with the statutory definition**

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[5] 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 (April 18, 2022) ("SIFMA AMG Letter I"), *available at* https://www.sec.gov/comments/s7-02-22/s70222-20124028-280153.pdf; letter from William C. Thum, Managing Director and Assistant General Counsel, SIFMA AMG, to Vanessa A. Countryman, Secretary, SEC (June 13, 2023) ("SIFMA AMG Letter II"), *available at* https://www.sec.gov/comments/s7-02-22/s70222-204000-410782.pdf.

[6] Letter from Robert Toomey, Managing Director and Associate General Counsel, SIFMA, to Vanessa A. Countryman, Secretary, SEC (April 18, 2022) ("SIFMA Letter I"), *available at* https://www.sec.gov/comments/s7-02-22/s70222-20123991-280133.pdf; letter from Robert Toomey, Managing Director and Associate General Counsel, SIFMA, to Vanessa A. Countryman, Secretary, SEC (June 13, 2022) ("SIFMA Letter II"), *available at* https://www.sec.gov/comments/s7-02-22/s70222-20131150-301347.pdf; letter from Robert Toomey, Managing Director and Associate General Counsel, SIFMA, to Vanessa A. Countryman, Secretary, SEC (June 13, 2023) ("SIFMA Letter III"), *available at* https://www.sec.gov/comments/s7-02-22/s70222-204799-411623.pdf.

of "exchange" to mitigate the risk of ambiguity for market participants. As a critical part of any future re-proposal, the Commission must fully tailor the scope to only "exchange-like" activities and provide market participants with meaningful guidance that would allow them to effectively interpret the Commission's intended application of such re-proposal. Such re-proposal must explicitly carve out certain systems and activities from the definition of "exchange" and the application of Reg ATS. This would align with the statutory definition of "exchange" as set forth by Congress because such systems do not create a "market place" or facility that brings together purchasers and sellers of securities and do not perform the functions of an exchange as that term has been understood by market participants for nearly 100 years.[7] Failure to make these conforming changes would likely result in significant harms to the efficiency and resiliency of markets and negatively impact investor outcomes.

III. **Most compliance requirements applicable to Reg ATS are unworkable when applied to "communication systems."** Systems that function as "transmission pipelines" (systems *lacking* imposed dealers, communication parameters, aggregation of buyers or sellers, and trade-execution capabilities facing the aggregation of buyers or sellers) ("Communication Systems") do not perform the same functions as, nor present characteristics similar to, exchanges or alternative trading systems ("ATS"). These dissimilarities make application of Reg ATS inappropriate and would likely result in impossible compliance obligations that would yield no discernable benefits to markets and investors. Application of Reg ATS to such systems would be misaligned with the policy objectives of the Proposal and leave market participants in the unreasonable position of being unable to comply with the rule in any manner.

IV. **In the event the Commission moves forward with the current Proposal, even with recommended carve-outs for communication systems, it must provide at least 2 years for implementation**. If the Commission finalizes the Proposal, even with explicit carve-outs for OMS, OEMS, and RFQ systems, we urge the Commission to recognize that market participants will need to make substantial changes to their current operating models and to provide a reasonable compliance date of at least two years from the effective date.

Discussion

I. The Commission should move forward with a re-proposal coupled with a thorough cost-benefit analysis.

As we have stated in previous comments,[8] SIFMA AMG and SIFMA support the Commission's high-level policy goal of ensuring that rules that govern trading venues keep pace with technological and market developments. However, we are concerned that the Proposal would expand the scope of systems subject to "exchange" or ATS treatment significantly beyond the regulatory gap identified by the SEC,

[7] 15 U.S.C. § 78c(a)(1).

[8] See supra notes 5 and 6.

which will certainly result in a host of unintended consequences unlikely to meet the statutory purposes and policy objectives of Reg ATS.

We believe that such an expansion must only capture third-party operated systems that allow the trading interests of multiple buyers and sellers to interact competitively ("many-to-many interaction") pursuant to the system operator's non-discretionary rules as to how the trading interests will interact.

We remain concerned that the language of the Proposal could be interpreted broadly to apply to a host of proprietary and vendor-offered systems designed to facilitate efficiencies and cost savings and reduce operational risk but lack key characteristics of an exchange or ATS. If there are limited specific systems that are targeted for justifiable policy concerns, the Proposal risks capturing a range of systems for which no detailed cost-benefit analysis has been presented. Moreover, the Proposal's ambiguity will lead to a plethora of requests for carve-outs of OEMS and RFQ systems for which the Commission's relevant policy considerations are not applicable. In light of these concerns, we recommend that the Commission re-consider the Proposal as currently drafted.

For example, asset managers use OEMS and RFQ systems to identify liquidity, monitor market conditions, and route and organize orders to marketplaces (*e.g.*, an exchange, ATS, broker-dealer, bank, or other source of liquidity). These systems allow users to manage investments more efficiently, improve fund-pricing practices, and reduce overall trading costs, thus enhancing the ability of funds to attain best execution on behalf of their investors. These systems provide significant benefits to the overall market and individual investors, and the Proposal would have a stifling effect on a range of innovative systems for which the Commission has provided no indication of problems nor risks of material adverse consequences.

The Proposal does not adequately explain why it is necessary to now impose further regulation (either through exchange registration or broker-dealer/ATS registration) to a wider array of systems and technologies that lack the functionality and historical touchpoints that have been necessary to be considered an "exchange" since 1998.[9] We support the Commission's statements in 1998 that "exchange regulation is designed to facilitate centralization and enhance the general public's opportunities to obtain trading information and to access trading interest."[10]

While there may be opportunities to modernize the "exchange" definition in light of technologies available today (e.g., anonymous RFQ protocols that serve as centralized liquidity pools), the Proposal lacks the analytical rigor applied to the 1998 reforms that addressed the definition of an "exchange" and created the ATS regulatory regime.[11] When the Commission expanded the definition of "exchange" in

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[9] See SIFMA Letter I, supra note 6, at 6-7.

[10] 63 Fed. Reg. 70844, 70900 (Dec. 22, 1998).

[11] *Transformation & Regulation: Equities Market Structure, 1934 to 2018*, Securities and Exchange Commission Historical Society, *available at* https://www.sechistorical.org/museum/galleries/msr/msr04c_reg_ats.php.

1998, it created a new category of registrants – ATSs – along with requirements for ATSs that were fit for purpose.[12] It did not simply apply all of the "exchange" requirements to the newly regulated ATSs.

As we detail below, existing ATS regulatory compliance requirements are not fit for purpose for OMSs, OEMSs, and disclosed RFQ workflows, and such misalignment strongly indicates that OMS, OEMSs, and disclosed RFQ workflows should not be regulated as "exchanges."

We find the Commission's explanations, that unregistered systems are not registered, does not itself establish a rationale for why these systems should now be deemed to be "exchanges" and be required to become registered. The explanation that systems which operate differently and perform different functions are not subject to "exchange" regulation, does not establish why these systems should now all be regulated as "exchanges."[13] Different systems that perform different tasks in different ways ought to be regulated differently.

Further, any decision to "regulate the unregulated" is only within the province of the Commission when it has been so instructed by Congress. Given the statutory limit of the definition of an "exchange," the significant benefits these systems provide and the minimal consideration of the potential costs under the Proposal as currently drafted, and the minimal investor protection benefits that regulation as an "exchange" would bring when applied to these systems, we recommend caution moving forward until a more thorough analysis has been performed.

That caution is warranted considering the negligible benefits that investors would gain if OMSs, OEMSs. and RFQ workflows were regulated as "exchanges." The Commission asserts that the proposed rule would "enhance regulatory oversight and investor protection,"[14] though OEMSs and communication systems are already connected to regulated marketplaces that are under regulatory oversight and keep an audit trail for the Commission to examine. The Commission further asserts, without providing quantifiable support, that the proposed rule would reduce trading costs and improve execution quality.[15]

It is unclear how this would be accomplished by regulating OMS, OEMS, and RFQ systems as "exchanges," as trading interests are sent to actual marketplaces for execution. Rather, trading costs would actually *increase* if there were fewer OMSs, OEMSs, and RFQ systems due to less competition and higher fees charged to investors. The Commission asserts that the proposed rule would enhance price discovery and liquidity because the newly regulated communication tools would report trades and

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12 See 63 Fed. Reg. 70844, 70847 (Dec. 22, 1998) ("In general, this approach gives securities markets a choice to register as exchanges, or to register as broker- dealers and comply with Regulation ATS. The Commission believes the framework it is adopting meets the varying needs and structures of market participants and is flexible enough to accommodate the business objectives of, and the benefits provided by, alternative trading systems.").

13 87 Fed. Reg. 15496, 15502 (Mar. 18, 2022).

14 87 Fed. Reg. 15496, 15618 (Mar. 18, 2022).

15 87 Fed. Reg. 15496, 15620 (Mar. 18, 2022).

have fewer system failures.[16] However, the regulated marketplaces and broker-dealers that are parties to the transaction already report the trades and already undergo business continuity planning, making the benefits of imposing this regulatory apparatus on the OEMS or communication tool unnecessary in light of the significant costs.

In requiring such systems to register, many technology providers would be unable to comply or would have to materially change their operating models in a manner that may make them less efficient, less secure for end-users (e.g., collecting and storing highly sensitive data on users' trading activity in order to satisfy reporting requirements, interposing credit limits between bilateral counterparties, second-guessing whether or not user-driven execution decisions satisfy "fair access" requirements for the system as a whole), and more susceptible to easily avoidable operational risks associated with the era of analog workflows.

The overall marketplace for trading technology would become less competitive and innovative due to the high barriers to entry imposed by unduly restrictive and burdensome regulation that is not tailored to the risks of their activity. OEMSs would likely pull back from offering users access to electronic trading functionality linked to the OEMSs, pushing the market to more manual workflows with greater operational risk.

In addition, commenters have repeatedly highlighted the risk of overreach due to the ambiguity of the proposal. As we explained in our June 2023 letter,[17] the wording of the Proposal, perhaps intended to capture a limited number of systems, risks being interpreted to extend to systems that facilitate efficiencies but do not offer competitive market trading capabilities. We believe that the proposed rule does not provide adequate clarification to avoid the potential capturing of such systems. Given this ambiguity, the Commission will likely be inundated with several carve-out requests for systems that are not applicable to the Proposal's policy consideration. For these reasons, we continue to advocate for clarification on the systems intended to be captured under exchange and ATS treatment.

II. In any re-proposal, the Commission should clarify the scope of systems subject to Reg ATS including specific carve-outs consistent with the statutory definition of "exchange."

While we urge the Commission to provide further clarification on the range of systems subject to exchange and ATS treatment under the Proposal generally, we recommend that the systems described below be expressly carved out from the final rule's scope.

This would align the Commission's proposed expanded definition of "exchange" with the statutory definition, which does not include communication systems that are not themselves the "market place[s] or facilities for bringing together purchasers and sellers of securities" and do not "otherwise perform[ ] with respect to securities the functions of a stock exchange as that term is generally

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16 87 Fed. Reg. 15496, 15621-22 (Mar. 18, 2022).

17 SIFMA AMG Letter II, supra note 5, at 2.

understood."[18] Additionally, a communication system can only be a "facility" of an exchange if it is "maintained by or with the consent of the exchange."[19]

While the Commission does not appear to contend that communication systems not maintained by or with the consent of an exchange perform the generally understood functions of a stock exchange,[20] the Commission's view is that the statutory definition of "exchange" is disjunctive such that if a communication system "provides a market place or facilities for bringing together buyers and sellers of securities," then that is enough for the Commission to regulate communication systems as "exchanges."[21] However, even if the Commission's interpretation of the statutory "exchange" definition is correct (we do not believe it is), the Commission ignores the critical words "market place or facilities" which appear before "bringing together purchasers and sellers of securities."

Communication systems not maintained by or with the consent of an exchange, which are the pipes market participants use to get to the marketplace or facility, cannot themselves be a market place or facilities of an exchange. Because such communication systems are not a "market place" or "facilities" pursuant to the statute, the Commission does not have the statutory authority to regulate such systems as "exchanges." Clarifying that the below-described OMS/OEMS/RFQ Systems are not "exchanges" under the proposed expanded definition would help avoid overstepping this statutory boundary.

A. Disclosed Messaging from One Market Participant

An OEMS tool, whether proprietary or licensed from a vendor, may offer an asset manager the ability to communicate efficiently with its liquidity sources and dealers. These types of messaging tools should be clearly excluded from exchange and ATS treatment (one-to-one). Specifically, the Commission should clarify that systems that route orders elsewhere for handling or execution—to a broker-dealer, an exchange, or an ATS—are excluded from the definition of "exchange." The Commission should make expressly clear that single-dealer platforms (further discussed below), OMSs, OEMSs, smart order routers, algorithms, direct market access or sponsored access offerings, and systems routing to liquidity providers and vendors in response to indications of interest and RFQs are out of scope and can rely on the existing exclusion from "exchange."

The same exclusion should apply for systems that allow individual market participants to message multiple market participants simultaneously (one-to-many). This could include an RFQ to multiple dealers where the dealers are aware of the requester's identity ("Disclosed RFQ"). These systems simply replace the asset manager's or broker-dealer's previous workflow where it used the

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18 15 U.S.C. § 78c(a)(1).

19 15 U.S.C. § 78c(a)(2).

20 88 Fed. Reg. 29448, 29458 (May 5, 2023).

21 88 Fed. Reg. 29448, 29458 (May 5, 2023).

telephone to call those same dealers for a quote. It is inappropriate to designate such an efficient replacement for a phone call to be a functional "exchange."

Given the breadth of the Commission's proposal, market participants are concerned that even a system that permits a one-to-one communication could be characterized as a system that brings together buyers and sellers because of the multiple transactions that could occur over time. For example, a market participant could use the system to communicate trading interests to buy securities in the morning, and then use the same system to communicate trading interests to sell securities in the afternoon. Under the Commission's approach in the proposal, such a system could, over time, be viewed as bringing together multiple buyers and sellers.[22] The Commission should clarify that such a system does not bring together buyers and sellers by specifying that it would analyze these systems on a per-interaction basis. A system that permits communications by a single user to buyers and sellers, over time, should not be viewed as having brought together buyers and sellers.

B. Asset Managers' Proprietary (Home-Grown) OMS/OEMS/RFQ Systems

Asset managers (users) develop proprietary systems to manage risk and create efficiencies in their workflow, including with respect to their order management and trade executions. While such systems connect the user to liquidity centers such as broker-dealers or trading venues, the internal system itself is not the liquidity center, and the asset manager uses its proprietary system as an efficient workflow tool that is a replacement for inefficient workflows such as phone calls.

For example, an asset manager may use its proprietary OMS/OEMS to send a disclosed RFQ to three broker-dealers. It is important to note that investors (clients of these asset managers) derive substantial benefits from these workflows in the form of superior execution efficiency and reduced trade error rates. Further, investors already benefit from the protections afforded by the broker-dealer and current-exchange regulatory frameworks that apply to the execution of their orders.

Moreover, as we detail below, an asset manager may license the workflow tools to other asset managers so that other asset managers can use those tools in their own technologically separated system. This should not convert the asset manager that developed the system into a vendor for its own proprietary use of the system. In such cases, the asset manager that created the technology does not send its trading interests to any of the asset managers that license the system – each asset manager simply operates its own version of the system.

For these reasons, the Commission should make clear that these types of proprietary OMS/OEMS/RFQ systems are not captured by its expanded "exchange" definition. Absent such clarification, the Proposal could disproportionally impair smaller investment advisers that would then need to expend resources to develop their own in-house proprietary systems.

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[22] 87 Fed. Reg. 15496, 15505-06 (Mar. 18, 2022).

C. Vendor-Sponsored OMS/OEMS/RFQ Systems

Asset managers and broker-dealers may license an OEMS created by a vendor. Vendors license such systems to individual market participants for each of their sole use and for the same purposes – for asset managers and broker-dealers to create and route orders, manage their risk, and create efficiencies in their workflows. Such systems usually permit users to do their workflows in their own technologically separated and secure instance of the technology, and often customize and configure the tool for themselves or request the vendor do so on their behalf.

For an asset manager, the tool may offer a communications link to dealers and other liquidity sources with whom the asset manager maintains relationships, however, such systems do not impose the portfolio of dealers but instead allow the asset manager to choose the market participant with whom it would like to communicate (subject to a bilateral agreement between the dealer and asset manager).

Obtaining a software license to a communication system does not get you access to any dealer or liquidity source. While such systems make it easier for asset managers and broker-dealers to communicate with their liquidity sources using industry-standard connectivity tools (e.g., FIX) and structured messages, they do not establish the parameters for communications. Rather, those parameters or structured messages (including drop-down menus to make users' choices easier to select) are individually established by the users and the liquidity sources to efficiently send information to one another.

In addition, the fact that more than one asset manager or broker-dealer licenses the technology is irrelevant because the technology does not give the user the ability to contact another user simply because they have both licensed the technology from the same vendor. Such systems do not aggregate buyers and sellers for trading purposes and do not provide for trades to be executed within the system. These systems lack the key features of an exchange discussed above because they do not aggregate trading interests from multiple buyers and sellers so that those trading interests can interact competitively according to non-discretionary parameters set by a third party. Just as asset managers and broker-dealers cannot view their OEMS technology as unique sources of liquidity – as they do not provide liquidity – neither should the Commission.

D. Single-Dealer Systems

As SIFMA has stated in prior letters, we believe it is imperative for the Commission to clarify that sell-side broker-dealer systems that provide capital and liquidity in a dealer capacity to clients are excluded from the definition of "exchange."[23] Such systems include single-dealer platforms that stream indications of interest, automated market making systems, algorithms that provide dealer capital to clients, central risk books, and broker closing cross systems.

[23] SIFMA Letter I, supra note 6, at 11.

III. Most compliance requirements applicable to Reg ATS are unworkable when applied to communication systems.

Compliance requirements under Reg ATS and other related rules underline why ATS treatment would be impracticable for application to systems that function as "transmission pipelines" (systems lacking imposed dealers, communication parameters, aggregation of buyers or sellers, and trade execution capabilities facing the aggregation of buyers and sellers) ("Communication Systems").

A. Trade and Transaction Volume Reporting

Communication Systems are not parties to transactions and therefore should not be required to report trades. The dealers and other execution venues (e.g., ATSs) to which the systems connect already report the trades, and accordingly, additional reporting would be duplicative and therefore potentially harm investors' and regulators' access to important market data. Users of the trade reports would have to expend time and effort to sift through duplicative trade reports for the same trade.

For example, the process to complete a single transaction could originate in an asset manager's OMS, go through an EMS, and then to a broker-dealer which then sends the order to a dark pool where the transaction is executed. Under the Commission's proposed framework, this single transaction would be reported four times in total if all of the communications tools were considered ATSs and if the broker-dealer and dark pool separately report trades.

The only volume that is relevant to the order routing choices of market participants is the actual volume at the point of execution, as it represents unique liquidity that market participants may want to interact with. The volume flowing through the OMS and EMS are merely pipes and do not represent addressable liquidity. Reporting such volumes to the market could create confusion around the actual aggregate amount of liquidity in the market and its location. Such confusion would make order routing decisions less clear and efficient, undermining the Commission's stated goal of improving execution quality.

The Commission should consider the widely recognized harms of duplicative trade reporting. The 2020 FIMSAC report articulated this concern and recommended a framework to address this issue without relying on the "exchange" definition.[24] Given the trade reporting issues that arise from regulating communication tools as ATSs, the costs are high and the benefits are uncertain. The Commission should address the problem of potential duplicative trade reporting through re-proposal of the rule and consideration of industry feedback. It is not sufficient for the Commission to address these important issues via staff FAQs published after an unclear rule is adopted.

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[24] *Recommendation Regarding Defining "Electronic Trading" for Regulatory Purposes*, SEC Fixed Income Market Structure Advisory Committee (Oct. 5. 2020), *available at* https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-recommendation-definition-of-electronic-trading.pdf.

In addition, Communication Systems may not have all the information required for trade reporting to the extent that executions occur on a different market center and such market centers handle the trade reporting. By design, communication tools are often secure pipes (frequently at the behest of users) such that the vendor or technology operator is not privy to the sensitive details of users' communications and would therefore have no knowledge that a user consummated a trade using the vendor's communication tool. For example, a user of a Communication System may choose to install the software on their own private server that the software provider does not control. As a result, to report a trade, market participants would be required to divulge and expose their confidential trade data to their technology vendor *for the sole purpose of duplicative trade reporting*.

If the technology provider were required to obtain this information from investors, investors' business relationships with their technology providers would be materially different and their information made less secure by virtue of another person having access to it. Further highlighting the incongruity of applying the trade reporting obligation to the Communication Systems is how market participants cancel or correct trades. If an asset manager and a dealer need to amend a trade, they would just call or message each other to discuss the amendment away from the Communication System. As a result, the Communication System's original trade report, to the extent that it had the details of the report in the first place, would be rendered incorrect by the transaction parties' amendment.

While noting that there is little benefit from additional transaction reporting by Communication Systems, there would be costs on Communication Systems and on the investors that use these tools. For example, members of a national securities association (i.e., FINRA registrants) and ATSs are subject to Consolidated Audit Trail (CAT) reporting requirements.[25] To the extent that these requirements apply to Communication Systems, there would be significant technical costs and burdens in addition to having to bear the costs of the CAT funding plan. In the end, investors would endure these additional costs for little gain, as Communication Systems would not report any useful information. The Commission has not addressed these additional significant costs on Communication Systems or *on investors* in its cost-benefit analysis.

We highlight these unintended results to the Commission to emphasize that applying the trade reporting obligation on Communication Systems is completely inappropriate and underlines why ATS treatment makes no sense.

B. Recordkeeping

The recordkeeping requirements applicable to ATSs and broker-dealers are particularly onerous to implement for an OEMS and these requirements would materially change the relationship between an investor and the technology provider.

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[25] See 17 C.F.R. § 242.613(g)(2); CAT Reporting Technical Specifications for Industry Members, (Feb. 28, 20020), *available at* https://www.catnmsplan.com/sites/default/files/2020-02/CAT-Reporting-Technical-Specifications-for-Industry-Members-v3.1-CLEAN.pdf.

Using an OEMS as an efficient workflow tool, orders may be raised at various stages within the asset manager's workflow such that the OEMS would not know at which point it "received" the order to mark the appropriate time stamp. In fact, the OEMS does not "receive" the order because it merely provides the pipes for a dealer/liquidity source to "receive" the order. Moreover, because Communication Systems are meant to be secure pipes for investors to send information to their dealers/liquidity sources, the technology provider may not have access to the detailed order and transaction information to keep records and blotters that ATSs and broker-dealers are required to keep.

Like the issues relating to trade reporting, if the technology provider were required to obtain this information from investors, investors' business relationships with their technology providers would be materially different and their information made less secure by virtue of another person having access to it. While we respect the Commission's efforts to create audit trails, we believe that the Commission has access to detailed records from registered investment advisers, dealers, and other liquidity sources like exchanges where transactions are executed.

Requiring technology providers to create additional (and duplicative) records does not add much to the Commission's ability to obtain information on securities transactions and stands as yet another reason ATS treatment is inappropriate.

C. 15c3-5 Risk Management Controls

To the extent that the Communication System permits parties who have a preexisting relationship away from the system to communicate in a fully disclosed manner, then the Communication System should not be required to enforce financial risk constraints (e.g., credit limits) or monitor for clearly erroneous transactions because counterparties know each other and can use their own systems for these controls and perform any "last looks" before entering into transactions.

It is unclear to us what benefit an investor receives if a Communication System were to intervene in the relationship between the investor and its dealer/liquidity source, which would certainly also raise costs on investors. At a minimum, an investor would lose the right to determine when the investor has, or has not, entered into a transaction if the Communication System is required to empower itself to break a trade. We do not believe that the Commission intended such a result that would diminish the rights of investors.

This issue is especially important because operators of Communication Systems are essentially software providers that do not have the sophistication or ability to manage risk on behalf of the counterparties to a transaction. They are generally focused on managing cyber security and operational risk related to their technology platform. They do not have the skill or expertise required to assess and appropriately establish credit limits - which requires a complex understanding of a client's investment strategies, assets under management, committed financing facilities, and degree of sophistication.

Software providers are, therefore, not well positioned to take on these important obligations, which are better suited (in terms of expertise and resources) for the broker-dealers and banks that

currently set these limits when engaging with their counterparties over any medium, including Communication Systems. This is unlike existing ATSs, which have the skill and sophistication to surveil markets and impose these kinds of requirements on market participants because they operate marketplaces, serve as liquidity sources, intermediate trades, and play a fundamental role in managing risks associated with these activities.

D. Certain ATS Requirements Applying to ATSs Which Meet a Volume Threshold

In response to Question 75 in the release for the re-opening of the comment period,[26] it is our position that requirements such as Fair Access, Reg SCI, and the Order Display and Access Rule that are keyed off of trading volume thresholds are not applicable to Communication Systems, as trades are executed away from the system.

Reg SCI is intended to address critical market infrastructure that is a single point of failure for the entire market such that if the system were to go down, then the entire market would be affected. When the Commission adopted Reg SCI, the Commission rightly recognized Reg SCI should apply to ATSs that represent "significant source[s] of liquidity."[27]

These concerns are irrelevant with respect to Communication Systems as they merely make efficient more manual processes for communication, providing investors with multiple methods of communicating with their liquidity sources and dealers. The Communication Systems are not themselves the sources of liquidity. Moreover, asset managers are subject to additional regulation to account for risks associated with their vendors and technology processes.

Accordingly, imposing a costly set of requirements on such asset managers' Communication Systems offers little elusive benefit while imposing certain high costs. Technology providers for Communication Systems would be unable to continue providing services at the current price points if such burdensome regulations were imposed on them.

For these reasons, the Commission should undertake a detailed cost-benefit analysis before imposing Reg SCI on Communication Systems. It should detail the precise benefits that investors obtain from the Reg SCI requirements that they do not get through other means, including by having multiple communication links to liquidity sources and dealers. And it should have realistic estimates of the costs associated with the requirements, including those related to maintaining geographically diverse back-up systems running concurrently with the main systems.

Fair Access may make sense for a unique liquidity pool such that market participants generally could not get access to liquidity if they were denied access. Systems that only provide a tool to communicate with disclosed participants with whom a market participant has an established relationship is not such a liquidity center.

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[26] 88 Fed. Reg. 29448, 29493 (May 5, 2023).

[27] 79 Fed, Reg. 72252, 72262 (Dec. 5, 2014).

For example, if a market participant did not have access to a Communication System to send a trading interest to a dealer who they know, the market participant would simply use another communication tool to contact the dealer.

Moreover, the Fair Access requirements that would require the Communication System to offer fair access to every other user of the system appear particularly inapt where users select the dealers with whom they would like to communicate. In response to a comment that the Fair Access Rule should not apply where the user has discretion over to whom they communicate, the Commission responded that "where ATS participants can select their potential counterparties, the Commission would view an ATS that implements the participant's choices as having adopted those as ATS standards. As a result, the ATS subject to the Fair Access Rule would need to establish reasonable written standards that, among other things, justify why the differences in access between the selected and not-selected counterparties are fair and non-discriminatory and thus reasonable."[28]

As to how a Communication System could comply with such a requirement, the Commission stated in footnote 675 that "in practice, the ATS participant making a selection of its potential counterparties would need to provide the ATS with its justification for selecting those counterparties, and the ATS would need to evaluate whether the stated justification comports with the Fair Access Rule."[29]

There are a number of issues with the Commission's proposed approach. First, we find it difficult to see how a given user's choice to communicate with one person or another should be attributed to the Communication System. Second, according to the Commission's stance in footnote 675, an asset manager that chose to send a trading interest to Dealer 1 and not to Dealer 2 could potentially spend its time justifying its choice to the Communication System, *every time that it communicates*. Users code rule-based methodologies to contact dealers through a Communication System to achieve optimal results for their clients over time and in accordance with their best execution obligations – and not on a per-order basis. It is unclear how, or even whether, the Communication System could evaluate the users' choices to communicate with Dealer 1 versus Dealer 2. And there remains a potential that the user's choices, which may be tied to their best execution obligations, would conflict with the Communication System's fair access obligations if such user's choices were "adopted" by the Communication System. This would be an unworkable framework for using a Communication System and adverse to the pre-existing best-execution requirements that asset managers are otherwise mandated to fulfill. It appears that this type of burden on investors is expressly contemplated by footnote 675, yet we have not seen any cost-benefit analysis that justifies imposing this requirement *on investors.*

We urge the Commission to re-consider its approach to these types of requirements as they are clearly inappropriate to Communication Systems where market participants communicate with each other on a disclosed basis.

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[28] 87 Fed. Reg. 15496, 15574 (Mar. 18, 2022)

[29] *Id.* at n. 675.

Similarly, the Order Display and Access Rule appears to be inappropriate for Communication Systems. As currently set forth in the rule, "displaying" an order to any person other than an employee of the System would trigger the rule if the trading volume threshold has been met. It would require the Communication System to provide national securities exchanges and broker-dealers (all non-subscribers to the Communication System) quotation data and access to transact against the orders "displayed" in the Communication System.

Applying this rule to a Communication System, which offers the ability for market participants to communicate with each other privately, would not make sense. Imposing this requirement on Communication Systems would cause investors' private communications with their dealers and liquidity sources to become public so that others could interact with the user. Yet again, such existing ATS compliance requirements highlight why treatment of such systems as ATSs is inappropriate.

E. Reg NMS Order Protection Rule

The NMS Order Protection Rule is a related rule that applies to trading centers. Because the definition "trading centers" includes "alternative trading systems,"[30] this rule would impact Communication Systems even when the trading center on which the execution takes place would have to comply with the Order Protection Rule.

It would be inappropriate to require Communication Systems to prevent the execution of trades at prices inferior to protected quotations displayed at trading centers because trades are not executed on the system. We do not think that the communication pipes should address the requirements of the Order Protection Rule when the execution venue to which the order is routed (and the trade is executed) is actually in the position to address these requirements.

IV. In the event the Commission moves forward with the current Proposal, even with recommended carve-outs for communication systems, it must provide at least 2 years for implementation.

In its re-opening of the comment period, the Commission asked in Question 30 whether it should delay the implementation of any final rule that it adopts.[31] The answer is yes.

The Commission should provide a compliance date of at least two years after the effective date. Technology vendors and market participants need time to evaluate any final rule, their business model, whether they can or will register as an exchange or ATS, and then make the necessary business and technological adjustments to effectuate these decisions, work that needs to be completed before the broker-dealer and ATS registration can begin.

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30 17 CFR § 242.600(b)(95).

31 88 Fed. Reg. 29448, 29464 (May 5, 2023).

In the meantime, those that determine to register will need to register as a broker-dealer, including by registering their representatives and personnel. And then both FINRA and the SEC will need to review the respective broker-dealer and ATS registrations for many new registrants. All of these tasks will take a tremendous amount of focused time and energy. Accordingly, the Commission should delay the implementation date for at least two years.

Conclusion

SIFMA AMG and SIFMA appreciate 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 expansive interpretations 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 and SIFMA, 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 or Ellen Greene at (212) 313-1287.

Sincerely,

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cc: The Hon. 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