April 25, 2024

By Electronic Submission

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC, 20549-1090

Re: File No. S7-07-23

Proposed Amendments to Regulation Systems Compliance and Integrity

Dear Ms. Countryman,

The Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide additional comments on the Securities and Exchange Commission's 2023 proposed amendments to Regulation Systems Compliance and Integrity (the "Proposal").[1] The resiliency of U.S. capital markets is a key priority for SIFMA and our members; however, we strongly believe the Proposal would not provide meaningful enhancements to industry resiliency, nor is it justified given its substantial costs which have not been adequately assessed in the Proposal's economic analysis.

In furtherance of emphasizing the critical concerns set forth in SIFMA's original comment letter submitted in response to the Proposal in June 2023, we believe it is important to share additional comments and

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[1] https://www.sec.gov/files/rules/proposed/2023/34-97143.pdf

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).

recommendations at this time.[2] The comments in this letter reflect ongoing industry analysis of the potential negative impacts of the Proposal on broker-dealers, issues raised in SIFMA meetings with Commission staff, and developments in the industry more broadly since the Proposal was published. We and our members continue to have significant concerns with the Proposal regarding the issues and risks it has been proposed to address. As described in our initial letter and further discussed below, the Proposal would impose on certain broker-dealers ("Affected Broker-Dealers") a regulatory regime that was designed and established for clearinghouses and other potential single points of failure and one that is not fit for purpose in respect of broker-dealers, leading to significant costs, problematic outcomes, and inappropriate burdens on competition, with no discernible benefits. Moreover, the Proposal would mandate this regime at the very same time that the Commission is likely to be imposing significant other changes and further burdens on broker-dealers and other market participants. The lack of prioritization or adequate assessment of the collective impact of the numerous changes the Commission has in contemplation for broker-dealers and the U.S. markets more broadly does not figure into the assessment of costs, nor has the Commission reckoned with the risks it is itself introducing by imposing assorted new requirements, particularly those related to market structure, and additional and unnecessary burdens even before some new equilibrium is reached. The imposition of Regulation Systems Compliance and Integrity ("Reg SCI") on Affected Broker-Dealers could create more risks than the theoretical problems it would address.

First, the Proposal does not support the underlying premise of the Proposal and its supposition that Affected Broker-Dealers (or any broker-dealers at all) pose market-wide resiliency concerns. As discussed in more detail below, the nature of broker-dealer activities combined with the robust regulatory framework already applied to broker-dealers strongly supports the opposite conclusion: that broker-dealers are both resilient and substitutable, making it highly unlikely that a disruptive outage at any one firm would result in market-wide resiliency issues. Claiming that the rulemaking ameliorates an industry problem, without demonstrating there is actually a problem, is not reasoned decision making, and in doing so the Commission violates a central principle under the Administrative Procedure Act ("APA") and the Commission's own guidance when it fails to establish the need for the regulatory action being taken.[3]

Second, the Proposal extends a regulatory framework tailored for exchanges (and certain higher-volume ATSs), market utilities and other critical market infrastructure providers to an entirely different category of SEC registrant, without addressing the various material differences in the nature of these businesses and their activities. Failing to meaningfully consider these distinctions and reflect them in a more tailored approach is a critical flaw that affects every key aspect of the Proposal. It is a shortcoming and cannot withstand scrutiny, certainly not in the flawed analysis set forth in the Proposal. Among these flaws, two in particular are the significant number of broker-dealer systems that the Proposal would subject to Reg SCI and the geographic diversity requirements that serve no practical benefits in the context of broker-

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[2] https://www.sec.gov/comments/s7-07-23/s70723-204779-411723.pdf
[3] Current Guidance on Economic Analysis in SEC Rulemakings (Mar. 16, 2012), *available at* http://www.sec.gov/divisions/riskfin/rsfi_guidance_%E2%80%8Cecon_analy_secrulemaking.pdf.

dealer trading activities – and that run contrary to the way many broker-dealers have carefully and thoughtfully designed and deployed various systems. While there are others, these represent oversights and should be squarely addressed before the Commission proceeds. It makes no sense to subject so many broker-dealer systems to misapplied regulations and to require geographical dispersion as contemplated in the Proposal – these are outdated and inapposite requirements that will drive up costs for Affected Broker-Dealers and their customers in turn without commensurate benefits and at the risk of creating risks that do not currently exist for affected firms and their customers.

Third, the Proposal would impose a substantial burden on competition. Specifically, the Proposal would impose significant costs on the subset of broker-dealers selected by the Commission to which Reg SCI would apply (i.e., Affected Broker-Dealers). The Proposal fails to justify the arbitrary trading and asset thresholds used to extend Reg SCI to Affected Broker-Dealers, and we have been unable to obtain any clarification regarding the types of specific trading activities that the Proposal is attempting to address. Nevertheless, the arbitrary thresholds established in the Proposal would subject direct competitors, including competitors with similar market share involved in the same types of trading activity, to vastly different outcomes in terms of regulatory requirements and costs. This could significantly alter competitive dynamics across market segments and trading activities, and have material negative impacts on liquidity more broadly.

Fourth, the Proposal's economic analysis is inadequate and flawed. The Proposal's analysis significantly underrepresents the costs of the Proposal, suggesting that the Commission did not consider the scope and nature of broker-dealer systems and activities affected by the Proposal before it was issued. The Proposal would likely result in hundreds of millions of dollars of costs to Affected Broker-Dealers per year. All for benefits might not be commensurate given the potential burdens on competition, reduced efficiency, and potentially increased operational risks. For example, SIFMA strongly believes that the Proposal's "air gapping" requirements will increase potential points of failure and cybersecurity attack vectors. Besides increasing risks for Affected Broker-Dealers, the justification offered in the Proposal for its imposition will likely not survive review under the APA, neglecting an agency's fundamental responsibility to establish a "rational connection between the facts found and the choice made."[4] Likewise, imposing overly burdensome notice requirements on Affected Broker-Dealers will distract from their continuing resiliency efforts and will not provide the claimed benefits to justify its costs. We have heard anecdotally about the distraction Reg SCI notification requirements present to those entities currently operating under the regime. Dealing with reporting, in many cases of inconsequential foot faults, takes up disproportionate time and attention in relation to addressing actual substantive issues for existing SCI entities. We do not understand why the Commission is doubling down by imposing such a burdensome regime on a new array of non-critical market participants rather than first taking time to consider ways to improve, streamline and clarify expectations around the current regime for those entities

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[4] *Motor Vehicle Mfrs, Ass'n of U.S. Inc. v. State Farm Mut. Auto. Ins. Co,,* 436 U.S. 29, 43 (1983) (*quoting Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962)).

subject to it. To be sure, a regime like Reg SCI makes sense for entities performing critical market functions that represent single points of failure, but that regime needs improvement to make it more purposeful and impactful and to alleviate (rather than magnify) some of its shortcomings. We do not understand why it would be exported essentially wholesale to an assortment of entities for which it will be even less well suited.

The Proposal particularly needs robust cost benefit analysis given that it does not demonstrate material market impacts from systems disruptions at broker-dealers (much less the subset of broker-dealers the SEC has identified as in-scope) to warrant the major costs associated with the Proposal, nor does the Commission's economic analysis accurately capture the substantial costs of applying a regulatory regime that was designed for very different types of market participants. In this regard, the Proposal's economic analysis does not meet the Commission's statutory obligations to appropriately conduct such assessments.

Finally, the Commission is extending the existing Reg SCI regime without considering whether the regime currently serves its intended purposes for the entities it already applies to. In the last year, current SCI entities have experienced a number of outages and, over the course of the SEC's imposition of Reg SCI on in-scope entities, we have seen no any appreciable improvement to how those venues operate or the information they share with other market participants, such as broker-dealers, who can be affected by those outages. These outages call into question whether Reg SCI is providing the benefits the SEC now claims, and whether it would provide such benefits with a broadened scope.

The Exchange Act requires the Commission to determine whether a rulemaking will "promote efficiency, competition, and capital formation"[5] and prohibits any rulemaking that "would impose a burden on competition not necessary or appropriate in furtherance of the purposes" of the statute.[6] Given the inadequacies in its assessment of the burdens associated with the Proposal and the lack of evidence that there will be commensurable benefits, much less that the Proposal will promote efficiency, competition or capital formation, the Commission has not met its statutory obligations and therefore should not proceed with this Proposal.

1. The Commission Failed to Demonstrate that Affected Broker-Dealers Pose Market Wide Resiliency Concerns

Broker-dealers are extremely resilient, driven by a combination of their role in the market, robust regulatory requirements, and fierce competition among firms for customers and order flow. This is particularly the case for Affected Broker-Dealers. This resiliency, combined with the highly substitutable nature of broker-dealer businesses, makes it highly unlikely that a disruptive outage at any one firm would

[5] 15 U.S.C. 78c(f)
[6] 15 U.S.C. 78o(c)(2)(e)

create market-wide issues. This stands in contrast to current SCI entities like listing exchanges, securities information processors, and clearing agencies.

A. Broker-dealers are highly substitutable

In suggesting that Affected Broker-Dealers could pose market-wide resiliency concerns, the Commission failed to account for the market reality that broker-dealers are highly substitutable. This is true for broker-dealer market making activities, execution services, and others.

In equities and options, there are many liquidity providers who display quotations on exchanges and send orders to ATSs, that will continue to provide liquidity in the event one or even several liquidity providers temporarily withdraw from the market. SIFMA noted in its June 13, 2023 comment letter in response to the Proposal that "[i]f a particular broker-dealer acting as a trading center becomes unavailable (or simply decides to stop trading), order flow can immediately and seamlessly be routed to another broker-dealer performing the same function without issue. This dynamic of redundancy in the broker-dealer marketplace is well documented and is not simply a happy accident, but rather is the result of clear regulatory expectations."[7] According to one recent survey, 91% of buy side firms use more than two interfaces to facilitate their trading.'"[8] This survey demonstrates that significant redundancies exist within and among providers in the broker-dealer industry.

With respect to institutional execution services, institutional clients work with multiple broker-dealers to achieve their investment objectives. This is considered best practice, and we understand it to be an accepted expectation under other Commission rules. For example, SEC-registered investment advisers have multiple relationships with various broker-dealers. These advisers are subject to a broad fiduciary duty to seek best execution on behalf of clients when trading.[9] In order to fulfill that obligation, firms typically keep an approved list of multiple brokers that then compete for the adviser's orders and are periodically evaluated to assess execution quality, including their reliability. According to one survey, large asset managers engaged with an average of 46 U.S. equity execution brokers, medium asset managers with 32, small asset managers with 28 for an overall average of 36 U.S. equity execution brokers per surveyed manager in 2023.[10] In fixed income, deeper approved broker lists are common given the nature of the dealer market and the breadth of expertise and capital that is required across so many different sectors and sub-sectors. According to another survey, investment managers typically had over 10 meaningful relationships with Government Bond Dealers in 2023.[11] No one broker-dealer

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[7] https://www.sec.gov/comments/s7-07-23/s70723-204779-411723.pdf
[8] Referring to The Trading Intentions Survey 2022, "New platforms and late bloomers are all seeing greater interest," The Desk (April 7, 2022), https://www.fi-desk.com/research-trading-intentions-survey-2022/

[9] In addition, we note that the Commission staff has interpreted Rule 206(4)-7 to require registered investment advisers to plan for certain business continuity events, including the disruption of service providers such as one of the adviser's broker-dealers.

[10] See Larry Tabb and Jackson Gutenplan, Bloomberg Intelligence, "Equity Trading 2024: Commissions and Rates", December 18, 2023.
[11] See Kevin McPartland, Coalition Greenwich, 2023 North American Fixed Income Study, March 1, 2024.

represents a single point of failure for these entities. And yet the Commission does not appear to take this into consideration in the Proposal.

As further indication of resilience across entities in this space, broker-dealer operations demonstrated robust resiliency during the unprecedented disruptions of Covid-19 and rapid transition to remote operations, maintaining continuity of services supporting end customers and markets. This is due in large part to robust business continuity plans implemented as well by asset managers and third-party vendors. This robust resiliency framework at investment advisers enabled them to adapt quickly to large scale disruptions, not just in the United States but also globally. [12]

Further, while the Commission staff has previously noted six business continuity plan areas that Investment Managers should revisit, staff did not specifically mention problems in investment adviser's ability to execute, implement new investment strategies, meet redemptions in a timely manner, or other areas that would indicate a lack of resiliency or concerns with respect to Affected Broker-Dealers.[13]

Recent conversations with Commissioners and staff indicate that a Commission concern may exist with respect to smaller investment advisers having adopted arrangements with multiple broker-dealers to support resilient operations.[14] If this is indeed a driving concern, then the solution is not to require the largest broker-dealers to undertake a major redesign of their operating systems to conform to this resiliency framework of questionable merit, particularly given that there has been no assessment and the experience of current SCI entities since 2014 has not demonstrated that this approach definitively increases operational resiliency.

B. Competition and Commercial Incentives Already Promote Broker-Dealer Resiliency

If systems outages were to temporarily prevent a broker-dealer from trading, it would have a direct, substantial reputational and revenue impact on the impacted broker-dealer. Broker-dealers face direct financial exposure if they are unable to meet their obligations to clients, both through lawsuits for failing to meet their contractual obligations to clients as well as regulatory fines associated with certain market functions, such as order routing and execution. In contrast, many current SCI entities serve as single points of failure (e.g. listing exchanges, SIPS, and clearing agencies), and in the context of exchanges, are protected by strict limitation of liability provisions that often cap damages at an aggregate of $500,000 per month. Moreover, many existing SCI entities have regulatory immunity from liability in the performance of their regulatory obligations. The SEC has not sufficiently considered the significant commercial incentives that cause broker-dealers to invest significant resources into operational resiliency.

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[12] Megan Butler, Executive Director of Supervision – Investment, Wholesale and Specialists, UK Financial Conduct Authority, noted "In operational terms, advisors and wealth managers responded well to the onset of the coronavirus crisis."

[13] See Select COVID-19 Compliance Rise and Considerations for Broker-Dealers and Investment Advisers, August 12, 2020. Available at https://www.sec.gov/files/Risk%20Alert%20-%20COVID-19%20Compliance.pdf.

[14] See memorandum of meetings with SEC Officials and SIFMA available at https://www.sec.gov/comments/s7-07-23/s70723.htm]

C. Existing Regulations and Standards Already Address Broker-Dealer Resiliency

The mature resiliency infrastructure in place at broker-dealers is not only driven by client expectations, but reflects broker-dealers' compliance with a robust range of existing regulatory requirements and adherence to industry standards. SIFMA provided a detailed list of some of the key existing regulatory frameworks that guide firm resiliency today in our June 2023 response to the Proposal.[15] Key examples include Exchange Act Rule 15c3-5 (Market Access Rule); FINRA Rule 4370(a), (c) and (e), Reg SP, FINRA Cyber Practices, FFIEC IT Examination Handbook, as well as industry standards such as the NIST Cybersecurity Framework. Additionally, many Affected Broker-Dealers are subject to additional cyber and resiliency requirements, including those from state and federal banking regulators, as well as regulators in other jurisdictions. In aggregate, these regulations effectively set a robust standard for resiliency.

Unlike Reg SCI, these rules were designed to address risks specific to the activities and structures of broker-dealers and financial institutions more broadly, address risks specific to these entities and their roles in the market, and have mature implementation programs underway within such firms. This is in contrast to the Proposal, which as discussed below would apply a framework originally developed for market infrastructure providers that operate with fundamentally different systems and configurations and perform different roles in the market.

Not only is the Proposal duplicative of – and sometimes at odds with – the resiliency regulations which firms already comply with, it imposes substantial additive costs and compliance requirements because affected firms cannot simply import existing approaches. Rather than improving resiliency, this layering of the existing rules with new requirements in the Proposal creates burdens with little gain. If adopted, the Proposal would require in-scope firms to effectively stand up two separate compliance regimes, without realizing economies or efficiencies. On the contrary, they could reduce firm resiliency both by mandating prescriptive changes to existing technology and security infrastructure, and by imposing additional notification and reporting requirements that will divert firm resources but neither increase their resiliency nor provide meaningful information to the Commission.

The Commission should not proceed with the Proposal and instead should review existing broker-dealer resiliency requirements. Any additional Commission action should only proceed in response to an identified need, and the Commission should first consider whether it can achieve the desired end by supplementing existing rules applicable to broker-dealers, such as through the Commission's contemporaneously issued "Cybersecurity Risk Management Rule for Broker-Dealers" proposal.[16] The Commission has a statutory obligation to consider non-frivolous alternatives to a regulation and to

[15] Appendix A of the SIFMA comment letter available at: https://www.sec.gov/comments/s7-07-23/s70723-204779-411723.pdf
[16] https://www.sec.gov/files/rules/proposed/2023/34-97142.pdf

conduct a full analysis of such alternatives.[17] By not considering the alternatives of supplementing existing rules, the Commission has not fulfilled this statutory obligation.

2. Reg SCI Is Not Tailored to Broker-Dealer Activities or Systems

The Proposal fails to acknowledge the significant differences between the scope of broker-dealer activities and systems that would be subject to the Proposal relative to the systems and activities of current SCI entities. The Proposal extends a regulatory framework tailored for exchanges, utilities and other market infrastructure providers to an entirely different category of SEC registrant without accounting for the material differences in the nature of their respective business and activities. The non-exhaustive list below demonstrates that Reg SCI is neither reasonable nor appropriate in the context of broker-dealers.

A. Scope of Systems

The breadth of broker-dealer systems that could be swept into the core definition of "SCI System" demonstrates the incompatibility of Reg SCI in the context of broker-dealers. The definition of an "SCI System" includes "all computer, network, electronic, technical, automated, or similar systems" that directly support trading or order routing, among others. The scope of SCI Systems for existing SCI entities is vastly different than those of a broker-dealer. For existing SCI entities, Reg SCI systems are generally limited and isolated. For example, Reg SCI generally applies to exchange matching engines and regulatory reporting systems, such as dissemination of information to the SIP and trade reporting (connectivity) to NSCC. It applies to a very limited set of critical systems.

In contrast, broker-dealer SCI Systems would appear to include, among others, systems related to market making activities, facilitating trading activities (including customer data, connectivity in/out to other trading venues and regulatory reporting, such as the SIP, TRACE, TRFs, its matching engine, etc.), settlement and clearance systems, a much wider scope. Numerous SIFMA members have estimated that thousands of systems would potentially be subject to "air gapping" if the Proposal were to be adopted. The Proposal fails to consider the significant number and scope of broker-dealer systems that would be subject to the Proposal, nor does it address what makes them appropriate for inclusion for purposes of an SCI regime.

The impact would be even greater for Affected Broker-Dealers which are designated as SCI entities for multiple product categories, or where the volume levels that bring them above the thresholds are driven by multiple different business lines, bringing even more systems into scope. For example, a broker-dealer which meets volume threshold tests for both listed equities and exchange traded options, and has

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[17] *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005) (finding that the Commission is required to "do what it can to apprise itself" of the economic consequences of a proposal, including considering non-frivolous alternatives.); *Am. Petroleum Inst. v. SEC*, 953 F. Supp. 2d (D.D.C. 2013) (finding that the Commission was required to a give a full analysis of the alternatives given the burden the rule would place on competition).

its volume in those businesses driven by a combination of institutional and retail clients, would see a substantial proportion of its technology and systems brought in scope. This is particularly the case given the number of systems necessary to support covered activities across the order and trade lifecycle.

The challenges presented by designating Affected Broker-Dealers themselves as SCI entities are fundamentally different from the limited subset of broker-dealer affiliated alternative trading systems (ATSs) which are in-scope under the current regulation. Importantly, while these ATSs are affiliated with broker-dealers, Reg SCI currently covers only the ATS and its systems, not those of the broker-dealer as a whole, providing a much more confined and well-defined set of in-scope systems. Additionally, the in-scope functions carried out by the ATS and the systems which support them are closely analogous to those at non-broker-dealer exchanges and market venues.

In contrast, the Proposal's expansion of Reg SCI to cover Affected Broker-Dealers broadly, as opposed to just their affiliated ATS, would bring into scope a far broader range of systems, many of which are extremely different from those at current SCI entities. These potentially in-scope systems are fundamentally different from those in broker-dealer affiliated ATSs, across multiple dimensions, including scale, integration with other functions and the broader enterprise technology architecture, and complexity. The Commission does not offer a reason as to why the rationale that previously distinguished ATSs from their broker-dealer operators for purposes of establishing the reach of Reg SCI has changed. Nothing has fundamentally changed since the adoption of Reg SCI about how our markets operate or the roles performed by these different kinds of intermediaries, and no substantive reason for the expansion of Reg SCI has been articulated. The Commission has similarly failed to articulate why each of the specific requirements of Reg SCI should apply, and would make sense to apply, to Affected Broker-Dealers. It appears the Proposal does not take into consideration lessons learned from the current Reg SCI rules or that there are any tangible improvements that Reg SCI has established among entities on which it is currently imposed.

B. Notification Requirements

Similarly, the Proposal's expansion of Reg SCI's notification regime to Affected Broker-Dealers is not an appropriate application of that framework to broker-dealers. Reg SCI establishes requirements for SCI entities to provide notification to the Commission of "completed, ongoing, and planned material changes to their SCI systems and the security of indirect SCI systems," as well as to provide notification when in-scope systems are affected by an "SCI event."[18]

The notification regime in Reg SCI was created for current SCI entities, most of which must file rule changes when making material changes to how their systems operate. As described above, however, the Proposal would apply to potentially thousands of broker-dealer systems that are refined and altered in

[18] https://www.sec.gov/files/rules/proposed/2023/34-97143.pdf

the regular course of business – sometimes on a daily or weekly basis. Fundamentally, the proposed requirement for the notification of systems changes would be nearly impossible to execute for Affected Broker-Dealers, given the number of systems potentially in scope and the number of changes – whether small or large – that are made in the course of a year. Broker-dealers are responsible for supporting thousands of clients, and make routine – yet in scope – systems changes as a regular part of servicing their needs. The sheer volume of information that would have to be collected and provided, and without any attendant benefit to regulators, regulated entities, or underlying customers and other market participants, underscores the fatal flaws from which the cost benefit analysis suffers.

In connection with this requirement, the Commission did not develop a basic understanding of the scope and types of systems that would be subject to the Proposal, the types of changes that are regularly made, and the threshold for notifications – all of which are foundational to determining the volume of notifications that would be required and the costs it would impose on Affected Broker-Dealers to provide them. Until that analysis is done, the Commission has no basis to determine the scope of the burdens for Affected Broker-Dealers.

The Proposal would also require Affected Broker-Dealers to make notifications to the Commission following "intrusions," yet the overly broad definition of "intrusion" in the Proposal would create a massive volume of reports with little value to the SEC. Large financial institutions on a daily basis receive numerous attempted intrusions, which are deflected by robust cyber defenses. Under the proposed definitions, each of these unsuccessful, routine probing attempts would trigger a notification requirement, generating substantial effort for Affected Broker-Dealers and providing a flood of reports of no analytic value to the Commission.

C. Geographic Diversity Requirements

The Proposal would also mandate Affected Broker-Dealers maintain backup systems which are geographically diverse. Given the broad range of functions and the systems that support them which are covered by the Proposal as discussed above, a considerable proportion of an Affected Broker-Dealer's technology infrastructure would need to be duplicated at an alternate location. These systems, and secondary staffing needed to support them, would represent a major and unjustifiable cost to Affected Broker-Dealers. As these firms have already developed resiliency strategies tailored to their businesses, this added requirement would be a substantial cost, with questionable benefits to resiliency which the Proposal fails to demonstrate.

The Proposal does not demonstrate that arbitrary geographic diversity requirements are in fact the most effective way to promote firm resiliency in critical functions, as opposed to other resiliency strategies adopted by firms today, such as regularly testing and updating business continuity plans. Nor are geographic diversity requirements particularly effective counters to a range of risks that could affect firm operations but are uncorrelated with a specific location. For example, cyber risks, third-party risks, or risks from technology change management are exogenous to the specific locations a firm is operating in and would not be mitigated by a geographic diversity requirement. While there are a discreet set of risks

which are associated with a given location, such as natural disasters or dependance on utilities and infrastructure, these are a subset of the broader risks which Reg SCI aims to mitigate and are already being addressed by industry business continuity planning best practices.

Nor does the Proposal consider how geographic diversity requirements would impact Affected Broker-Dealers' ability to best serve their clients in business lines where distance to exchange data centers is important.

The securities industry's response to the COVID-19 disruptions and the smooth transition to widespread remote staffing even amid turbulent market conditions also calls into question whether prescriptive geographic diversity requirements are needed to prepare for disruptions. These ideas are anachronistic and there is no acknowledgment of plausible alternatives – yet another fatal flaw under the APA.

3. The Proposal Would Impose an Unnecessary and Inappropriate Burden on Competition

The SEC did not to set forth a rational basis for applying Reg SCI to a subset of registered broker-dealers that is based on arbitrary trading and asset thresholds. As proposed, this approach will impose substantial, unnecessary and inappropriate burdens on competition. The only justifications provided in the Proposal for the inclusion of some broker-dealers as opposed to others are volume and asset thresholds, which are fundamentally arbitrary and do not distinguish among types of market activity or roles being performed in the market.[19]

These thresholds will subject competitors engaged in the same activity, in the same markets, to vastly different regulatory requirements. For example, a broker-dealer engaged in multiple business lines within a specific asset class may exceed the Commission's volume threshold, but may account for less trading volume than its competitors in a specific market segment. Thus, under the Proposal, a broker-dealer with multiple businesses could face significantly higher costs to compete in a given market sector if it meets the Reg SCI threshold, even though it may account for less volume and its withdrawal would have smaller relative impact than a larger competitor that nevertheless is not a Reg SCI entity. This could significantly alter competitive dynamics across specific trading activities and have material negative impacts on market activity and liquidity more broadly. All the while, the Commission has failed to articulate why these trading and asset thresholds are relevant or bear some relationship to some objectively critical level of market activity or liquidity, much less any broader goals of an expanded Reg SCI regime.

At a minimum, rather than creating arbitrary thresholds, the Commission should specify the specific activities or roles broker-dealers play in the market about which the Commission is concerned that purportedly warrant the imposition of Reg SCI's resiliency standards. Broker-dealers conduct a range of

[19] SIFMA outlined other concerns with the justification and application of the proposed thresholds in our prior letter in response to the Proposal, available at: https://www.sec.gov/comments/s7-07-23/s70723-204779-411723.pdf

activities, including institutional capital markets activity such as market making and prime brokerage through supporting retail client trading or through clearance and settlement functions, yet the Proposal does not specify which activities undertaken by the broker-dealers present such a concern that they require the costly and burdensome expansion of the rules.

4. Robust Cost-Benefit Analysis is Critical Given the Scale of the Proposed Changes

The Proposal's cost-benefit analysis is flawed and does not meet the Commission's statutory obligations under the Exchange Act or the APA. Given the range of challenges inherent in extending the current Reg SCI framework to Affected Broker-Dealers as discussed above, it is critical that the SEC conduct more robust and defensible cost-benefit analysis around the Proposal to address – at a minimum – each of the issues discussed above. More holistically, that analysis should also assess 1) the major costs of the Proposal given its lack of tailoring and general unsuitability to broker-dealers; 2) its limited benefit given the high degree of resiliency and sustainability already mandated and demonstrated by broker-dealers under regimes that cannot be simply adapted to fit the Reg SCI framework; and 3) the aggregate impact of interrelated rules, including the proposed "Cybersecurity Risk Management Rule for Broker-Dealers, Clearing Agencies, Major Security-Based Swap Participants, the Municipal Securities Rulemaking Board, National Securities Associations, National Securities Exchanges, Security-Based Swap Data Repositories, Security-Based Swap Dealers, and Transfer Agents,"[20] and other recent SEC rule proposals.[21]

A. The Proposal Massively Understates the Costs

As described above, the Proposal generally fails to account for fundamental differences in systems architecture and the far greater number of systems that would be in scope at broker-dealers, as well as the fact that cost estimates for the original rule are greatly understated compared with the reasonably foreseeable costs of implementation. The Proposal could subject thousands of broker-dealer systems to Reg SCI, resulting in hundreds of millions of dollars of costs per year. This would include the systems duplication required to satisfy the geographic requirements, and the extensive reporting requirements that would subject Affected Broker-Dealers to burdensome reporting of minor events.

Cost benefit analysis should also aim to capture the costs of multiple additive requirements introduced by the Proposal and the costs of complying with them. This would include accounting for disparate reporting requirements, the notifications requirements regime for systems changes (reflecting the scale of in scope

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[20] See Proposed Rule, "Cybersecurity Risk Management Rule for Broker-Dealers, Clearing Agencies, Major Security-Based Swap Participants, the Municipal Securities Rulemaking Board, National Securities Associations, National Securities Exchanges, Security-Based Swap Data Repositories, Security-Based Swap Dealers, and Transfer Agents, 88 FR 20212, April 5, 2023.
[21] https://www.sec.gov/comments/s7-07-23/s70723-204779-411723.pdf

changes that occur at broker-dealers as discussed above combined with the uncertainty on the scale of notifications that would be required, as discussed above), implementation of new testing models, and compliance with personal liability requirements, among others. In addition to considering the costs of such additive requirements, such an assessment should carefully look at ways in which Reg SCI would differ from existing obligations and thus offer no efficiencies or economies associated with implementation.

The Commission likewise does not appear to consider that the Proposal could reduce resiliency and increase risks. The arbitrary thresholds for triggering Reg SCI, for example, could reduce the total number of liquidity providers (or cause liquidity provider's to reduce their activity in certain market segments), resulting in less liquidity and wider spreads. More generally, the application of expensive, burdensome requirements without regard for broker-dealers' existing practices, could limit the range of entities and third parties willing to meet such requirements, resulting in increased market concentration and reducing market resilience. For example, many ATSs will now "turn off" symbols and stop trading particular securities to avoid meeting Reg SCI volume thresholds thus reducing liquidity in those securities. Moreover, requiring broker-dealers to physically and logically separate in-scope systems as envisaged by Reg SCI and the Proposal would disrupt existing resiliency frameworks. The concept of physical and logical separation of in-scope systems is an inappropriate adaption of a concept originally developed in connection with the fundamentally different systems of exchanges and clearinghouses. Applying this requirement to highly complex and integrated broker-dealer systems would be extremely difficult, and if it were even possible it would not only be highly expensive, but very disruptive not only to how those systems support a broker-dealer's business operations, but would also break down the resiliency and cyber defenses that have been carefully built up around them.

The process of physical and logical separation would also take resources away from actual cyber defense resiliency enhancements, both during the re-architecting processes and on an ongoing basis as firm defenses must then account for multiple separate systems. Such an approach disrupts existing resiliency frameworks and capabilities that have been built into current systems configurations. It would also expand the attack surface available to adversaries. There is no evidence that a Reg SCI approach would work better for broker-dealers. The Commission does not acknowledge this in the Proposal, and proceeding on this basis presents a serious danger to the safe functioning of affected market participants.

The Proposal would also require Affected Broker-Dealers to restructure their operations and technology infrastructures – a process staff referred to as "air gapping" – to align with the model laid out in the Proposal – a model originally designed for very different types of entities - at great cost, with no benefit to resiliency, and additional danger to the safe functioning of these entities. This process creates additional threat vectors by introducing a number of new networks that will need to be hardened and defended using, as Google Cloud and Amazon Web Services noted in their letters, a highly prescriptive set of standards based on an understanding of technology and topology infrastructure from 2010. Today's

information technology infrastructure concepts are very different and provide enhanced state-of-the-art operational resilience that minimizes points of failure and cybersecurity attack vectors.[22]

Similarly, the testing requirements in the Proposal would misuse scarce industry resources that are better devoted to ensuring the smooth functioning of affected market participants. SIFMA, as coordinator of the annual Reg SCI testing requirements for current SCI entities, recognizes the scope of work required to support that testing, particularly given that nearly all of the potentially in-scope broker-dealers already participate in the test as mandatory testers with multiple SCI entities. The testing model for broker-dealers under the Proposal is not clear, given that it represents an extension of concepts originally designed for exchanges and utilities to very different entities.

For example, the current Reg SCI testing framework lays out a series of tests to identify mandatory designated broker-dealer testers, which are based on the roles of clients of market infrastructure providers – e.g. requiring testing for broker-dealers who account for a certain share of volume at exchanges or clearinghouses or play key roles, such designated market makers. It is not clear how these tests would be extended for Affected Broker-Dealers, or how a testing model organized around ensuring that key market participants would have access to back-up facilities of exchanges and clearinghouses would be applied to broker-dealers and their clients and counterparties. Even if testing requirements for broker-dealers under the Proposal at the firm level were to only require internal testing, it would still represent a substantial amount of firm effort, and one which is largely additive to existing firm resiliency requirements and best practices.

B. The Proposed Benefits are Unsupported and Theoretical

The Commission provides no quantitative analysis in support of the Proposal's named benefits. Instead, it relies only on general assertions regarding proposed resiliency benefits. No evidence in the administrative record supports these assertions, and indeed, there is strong evidence that the Proposal will not result in the benefits claimed, but will instead establish a competing set of expectations that divert attention and resources from approaches that are performing well now, but require constant vigilance.

As described above, for example, the Commission did not examine the degree of substitutability among broker-dealers and balance that against the costs of implementing the Proposal. The Commission also did not account for contemporaneous rulemakings tailored to broker-dealers, addressing similar concerns. This includes the Commission's proposed "Cybersecurity Risk Management Rule for Broker-Dealers." The Commission's analysis should be grounded in a range of data sources, including both those derived from reporting to the Commission as well as broader industry and SRO data. Additionally, we recommend the Commission incorporate evidence from historical market activity to try to quantify the benefits of the Proposal; as SIFMA and its members believe it is difficult to identify examples where

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[22] See Google Cloud Letter, June 13, 2023, at 5-6 available at https://www.sec.gov/comments/s7-07-23/s70723-205219-412302.pdf; See AWS at 10-13 available at https://www.sec.gov/comments/s7-07-23/s70723-249439-569282.pdf

broker-dealer outages due to technology or operational issues caused major sustained market impacts or harm to investors broadly. It should also evaluate relevant data regarding investment manager continuity plans, which the Commission did not do in the Proposal, particularly given the broker-dealer substitutability for investment managers discussed above.

Further, as discussed below, the Commission has not provided a baseline analysis that establishes the benefits or improvements that Reg SCI has brought about with regard to SCI entities as they operate today. If the Commission has not assessed how effective the current regime is or posited evidence of benefits that have followed from the imposition of Reg SCI on entities subject to its requirements today, it certainly has not offered evidence of a justification for extending its application. Likewise, we are aware of no publicly available study of Reg SCI at all – whether of its benefits or its shortcomings – performed by the Commission. It seems extraordinary to see an expensive and cumbersome regime that has not been shown to yield benefits being uncritically expanded to a range of entities for which it was never designed, nor is it now being meaningfully adapted.

Cost benefit analysis should also consider alternatives, such as targeted enhancements to broker-dealer appropriate rules (such as the pending cybersecurity rules), in contrast to the costly and cumbersome application of a rule not designed for or suited to broker-dealers.

C. Rules finalized since the Proposal further affect the cost-benefit analysis

Since the Proposal was released, there have been several major regulatory developments affecting the markets and institutions the Proposal would cover. Given the scale of the changes they represent, we encourage the Commission to revisit the Proposal to ensure that it takes into account these changes.

First are the major regulatory changes affecting the U.S. Treasury markets following the adoption of the SEC rules on mandatory Treasury clearing in December 2023. The Proposal expands Reg SCI to cover Treasury market participants, at the same time as the dynamics of the Treasury market and particularly post trade Treasury processes are set to be substantially reshaped. The Commission explicitly adopted the Treasury clearing rule to improve the resiliency of the U.S. Treasury market. Thus, the Commission should consider how and to what effect the adoption of the Treasury clearing rule removes a purported basis for the Proposal.

The Commission also needs to take into account the significant effect the Proposal would have on operating costs for the Consolidated Audit Trail (CAT). The significant developments in the operating and cost model for the CAT since the Proposal was released make it particularly critical for the Commission to assess the Proposal's impact on the CAT. In particular, the Proposal's cost benefit analysis does not consider the extreme expenses associated with CAT's compliance, and how those additional costs, not accounted for in the Commission's current economic analysis, would be passed to the broker-dealer community.

The Proposal's requirements around resiliency among cloud service providers ("CSPs") would be particularly impactful to the CAT. These concerns were detailed in the CAT LLC letter to the Commission

on the Proposal, which noted that "[t]o the extent that the Commission's proposal is meant to require the CAT to utilize different CSPs or on-premises back-up tools, CAT LLC urges the Commission to reconsider such proposals. Such a proposal would likely double the cost of the CAT. It also would double its security risk, as CAT Data would be located at two CSPs. Given the specialized expertise and technology needed to operate the CAT, such requirements also would raise questions regarding the feasibility of CAT LLC's ability to comply with them. Accordingly, CAT LLC urges the Commission to analyze the adverse cost and security effects of any such requirement."[23]

From a procedural standpoint, SIFMA members are also highly concerned that there may now be certain entities, specifically a number of private funds, that did not anticipate that they would have to register as dealers when the Proposal was first released. But now they may have to register following the Commission's February 6, 2024, adoption of an expanded definition of dealer in the "Further Definition of 'As a Part of a Regular Business' in the Definition of Dealer and Government Securities" ("Dealer Rule"). Their activity in U.S. Treasury Securities may cross the volume threshold and subject them to the Proposal, and now that the Reg SCI comment period has lapsed, these funds have been denied the opportunity to meaningfully participate in the comment process. While this letter is meant to describe the impact of applying Reg SCI on broker-dealers, these firms have not had the opportunity to provide the Commission with the challenges of applying Reg SCI to systems designed for investment management.

5. Before Expanding Reg SCI to a New Category of Registrants, the Commission Must Determine Whether the Framework is Functioning as Intended

Throughout 2023 and 2024, current SCI entities have experienced a number of significant and disruptive outages that have affected many of SIFMA's broker-dealer members. Since these outages call into question the effectiveness of the current rules in improving the resiliency of current SCI entities, SIFMA believes that the benefits in the economic analysis of extending Reg SCI to certain broker-dealers, against the quite measurable steep costs, are uncertain. To our knowledge there has not been a study on the effectiveness of the existing Reg SCI regime, whether as to its costs, its benefits, or its potential for improvements or enhancement. We recommend the Commission focus on looking into outages at entities that are currently in scope under the current rule – which we have not seen to date – before determining whether and if so how to expand it. We encourage the Commission to assess the effectiveness of Reg SCI on currently in-scope entities, review its benefits relative to its costs, and consider whether it is working as intended to support market resiliency. In SIFMA's view – and from anecdotal evidence from a number of in-scope entities – it is not.

Over the last 18 months, equity and options markets have been disrupted by several outages at current SCI entities. Given these entities are single points of failure in the market, these incidents created disruptions in the broader markets. These include the December 13, 2023 systems error at the Nasdaq

[23] See Brandon Becker, CAT NMS Plan Operating Committee Chair, Consolidated Audit Trail, LLC, Letter, (June 21, 2023) at 2, available at https://www.sec.gov/comments/s7-07-23/s70723-208299-421042.pdf

which affected thousands of orders, multiple outages at the Options Price Reporting Authority (OPRA) over the course of 2023 which affected data quality for investors, and the January 2023 outage at the New York Stock Exchange (NYSE), which disrupted the market opening and caused the halting of trading in several hundred stocks. More recently, on March 18, 2024, Nasdaq experienced issues with its matching engine which affected trading on a widespread basis.

These incidents were particularly impactful on the market since all of them occurred at infrastructure providers which are single points of failure. For example, the January 2023 NYSE outage affected the market open, a function which cannot be substituted with other equity exchanges or ATSs. This is in contrast to broker-dealers, who as discussed above, are highly substitutable for their clients.

Several of these outages occurred since the Proposal was published, and they should be reflected in the Commission's analysis of market infrastructure resiliency associated with the Proposal. SIFMA has not traced any market wide improvements to Reg SCI resulting from any of these incidents. The Commission has identified no improvements in market-wide resiliency to existing SCI entities as a result of the existing regime. Nor would the increase in the number of entities becoming SCI entities, if the Proposal were approved, lead to such enhancements or prevent outages. Instead, the Commission would have been flooded by reports of the individual entities that had to cope with the failures of the current SCI entities as those entities' failures affected their own operations. Given the redundancies among broker-dealers, they did not cause single point of failure problems, but if they are imported into the Reg SCI regime, they will effectively become an echo chamber of duplicative information pouring into the agency when already existing SCI entities do not meet their obligations.

If the markets are still seeing significant mission critical outages among entities already covered by Reg SCI, we question the cost-benefit justification for expanding it to Affected Broker-Dealers, who already have existing incentives and regulatory requirements for resiliency, as discussed above.

More broadly, we encourage the Commission to consider whether the scope of Reg SCI as it exists today makes the best use of the SEC's finite resources to support market infrastructure resiliency. Rather than expand the scope of covered entities, the Proposal allows the Commission to narrow it. Instead of expanding Reg SCI to cover certain broker-dealers, which represents a major investment with extremely limited resiliency benefits, we encourage the Commission to consider changing the scope of currently covered entities.

In our discussions with Commission staff, we recognize their concern for the resiliency of those entities in the market – whether market participants or infrastructure providers – who are critical to the functioning of the U.S. markets broadly and ensuring investors have consistent access to high quality markets. If the goals of Reg SCI are to ensure market resiliency at single points of failure, where incidents can affect market quality and investors, is it necessary to apply it to smaller, easily substitutable exchanges?

SIFMA recommends reconsidering whether the non-listing, low volume exchanges should be in-scope under Reg SCI. If, in the future, additional equity and options exchanges continue to be formed, would all

hypothetical 30 exchanges need to be SCI entities, even if the vast majority of them were non-listing exchanges and provided low single digit percentages of market volumes?

6. Rulemaking Process

Given the significant deficiencies with the Proposal, if the Commission were to proceed, material changes would need to be made to any final rule. Such changes would not represent a "logical outgrowth" from the current Proposal but would require a fundamental rethinking of the Proposal. Market participants, especially those most impacted, must be provided a meaningful opportunity to comment and react to the Commission's material changes and associated new economic impact analysis estimates. As such, the Commission must re-propose if it chooses to move forward with further rulemaking in this area. Any rulemaking in this area must be supported with robust cost-benefit analysis which addresses the gaps in the Proposal's economic analysis, which while lacking in the current proposal, would be non-existent regarding any material changes made.

SIFMA greatly appreciates the Commission's consideration of these comments and would be pleased to discuss them in greater detail. If you have any questions or need any additional information, please contact the undersigned at (212) 313-1262 or any of the following colleagues: Rob Toomey (212) 313-1124, Ellen Greene at (212) 313-1287.

Sincerely,

Charles De Simone
Managing Director, Technology and Operations

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