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VIA ELECTRONIC MAIL

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

Re: Proposed Regulation SEC (File No. S7-01-13)

Dear Ms. Murphy:

ITG Inc. ("ITG" or the "Firm") appreciates the opportunity to comment on the Securities and Exchange Commission's ("SEC" or "Commission") proposed Regulation Systems Compliance and Integrity ("Regulation SCI"). ITG is an independent execution and research broker that partners with global portfolio managers and traders to provide unique data-driven insights throughout the investment process. In addition, ITG operates an alternative trading system ("ATS") called POSIT® that conducts matches of orders from institutional investors and broker-dealers on a non-displayed basis.[1] ITG is well-positioned to comment on the proposed regulation as we not only operate our own ATS but also execute equities transactions via multiple market venues, including securities exchanges, market makers, and other ATSs. As described in more detail below, while ITG understands the events that have led the SEC to propose Regulation SCI, ITG believes the proposed regulation is overly broad in the entities it would capture ("SCI entities"), the requirements placed on SCI entities, and the reporting requirements mandated by the proposed regulation. ITG strongly recommends that the proposal be modified significantly so that the large costs it imposes are reduced substantially and thereby justified by the limited benefits reasonably achievable under the regulation.

[1] More information about ITG can be found in a letter ITG submitted to comment last fall on the issues raised during the SEC's Market Technology Roundtable. *See*, Letter dated October 22, 2012 from James P. Selway III and Sudhanshu Arya of ITG to Ms. Elizabeth M. Murphy, SEC, regarding the SEC Market Technology Roundtable ("Roundtable Comment Letter").

I. Overview and Objectives of Proposed Regulation SCI

The Commission is proposing Regulation SCI to address the systems compliance, security, and integrity of significant marketplace entities, such as national securities exchanges, clearing agencies, certain self-regulatory organizations ("SROs"), plan processors, and certain ATSs, collectively called SCI entities under Regulation SCI. The proposal is intended to address system vulnerabilities of the equities markets by imposing a vast array of systems requirements on these entities and to require these entities to report systems issues and material systems changes to the SEC.[2] Furthermore, the Commission believes that Regulation SCI would further the goals of the national market system and reinforce obligations under the Securities Exchange Act of 1934 ("Exchange Act") to require entities important to the functioning of the U.S. securities markets to carefully design, develop, test, maintain, and surveil systems integral to their operations.[3] The SEC characterizes Regulation SCI as a codification and broadening of its Automation Review Policy ("ARP") program and a reaction to recent systems issues of execution venues that have caused temporary disruption to the trading of certain securities.

As demonstrated below, however, Regulation SCI would impose an unreasonably burdensome technology and control standards on the automated systems of SCI entities. The vast panoply of technology and control standards that would be imposed on Regulation SCI entities is incredibly broad in scope, lengthy in number, and extremely detailed and costly. This letter will not comment on every aspect of this enormous proposal, but rather offer recommendations to address the major structural flaws in the proposal. If not addressed properly, these flaws could have a stifling effect on innovation in U.S. equity markets.

II. Indiscriminate Inclusion of ATSs Overshoots Regulation SCI's Objectives

National securities exchanges are self-regulated organizations that account for a large majority of equities trading volume in the U.S. securities markets. Furthermore, they play a critical role in the price formation and/or discovery process by displaying orders and making them publicly accessible for execution. Accordingly, national

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[2] Securities Exchange Act Release No. 34-69077 (Mar. 8, 2013) ("Proposing Release").

[3] Proposing Release at 29.

securities exchanges are appropriately included in the definition of the term "SCI entity," as they are systemically important to the functioning of the U.S. securities markets. However, proposed Regulation SCI would also cover market participants that do not significantly impact the fair and orderly operation of the securities markets. These include ATSs that meet certain volume thresholds that are much lower than the thresholds for ATSs currently under Rule 301(b)(6) of Regulation ATS (Capacity, Integrity, and Security of Automated Systems). The SEC estimates that there are currently 44 entities that would meet the definition of SCI entity under the proposed Regulation SCI. This figure includes 15 ATSs, which is far greater than the one or two venues that might meet the current threshold under Regulation ATS.

Before discussing specific concerns with Regulation SCI, it is instructive to explain three concepts regarding ATSs. First, ATSs and national securities exchanges play significantly different roles in the functioning of the U.S. securities markets. As marketplaces operated by broker-dealers, ATSs are more abundant than national securities exchanges. Moreover, ATSs account for a smaller portion of the total U.S. equities trading volume as they cater to investors with specific investments objectives, such as trading anonymously at un-displayed prices. Furthermore, the competitive environment also ensures that no single ATS accounts for a significant portion of the trading volume for all NMS securities. Specifically, broker-dealers, exchanges, and institutional investors employ routing systems that connect to multiple ATSs. If one ATS experiences a systems issue, trading would easily be shifted to other ATSs and/or internalizing broker-dealers (*e.g.*, market makers, block positioners, etc.). In light of their specialized role in the securities markets and the limited amount of trading volume executed on each individual ATS, ATSs should not be subject to the same Regulation SCI obligations that would be imposed on national securities exchanges and other SCI entities that are systemically important to the functioning of the U.S. securities markets.

Second, ATSs are already comprehensively regulated. Regulation ATS imposes compliance and notification requirements on ATSs that go far beyond broker-dealer regulation. Compliance with Regulation ATS is exhaustively examined by both the SEC and FINRA. Part of this compliance entails documentation of significant systems issues, which in ITG's experience are reviewed extensively by regulators during the examination cycle. In addition, Rule 301(b)(2) requires ATSs to notify the SEC 20 days prior to implementing a material change in operations and no later than 30 days following the end of a calendar quarter during which non-material changes are made. Beyond Regulation ATS, ITG is subject to Exchange Act Rule 15c3-5 (Market Access), which requires the Firm to establish, maintain, and enforce policies and procedures to manage and monitor

credit, financial, operational, regulatory, and legal risks on a real time pre-trade and post-trade basis for all orders accessing an exchange and/or ATS.[4]

Third, although the capacity, integrity, and security requirements of Regulation ATS only apply to ATSs that meet a high volume threshold, sponsors of ATSs nevertheless have a compelling business incentive to avoid systems issues. As noted in its Roundtable Comment Letter, ITG currently employs several "best practices" for ensuring the adequate testing of systems before deployment and continuous testing after deployment. Furthermore, ITG subjects its systems to a battery of tests to evaluate capacity and contingencies and detect unexpected circumstances, and the Firm is highly sensitive to potential issues of systems security. In today's extremely competitive environment, ATSs such as POSIT are highly motivated to minimize trading risks and errors and provide uninterrupted order matching services. Hence, ITG devotes significant time, capital, and other valuable resources toward the development and improvement of error prevention and recovery mechanisms that exceed regulatory standards.

Although ATSs have increased their collective market share over the past decade, virtually none of the major systems issues that have occurred in recent years have involved ATSs. Issues with initiation of secondary market trading for IPOs, temporary market outages, and systems failures have largely been confined to the stock and options exchanges, not ATSs. Notably, the systems reliability and soundness of ATSs have existed despite not having been subject to the ARP program.

ITG recognizes that, with the increased automation of the securities markets and trading process, the propensity for systems problems of major marketplaces to occur has increased. But, increasing the regulatory burdens on ATSs by subjecting them to a costly and complex array of technology requirements and notifications, like the ones under proposed Regulation SCI, is the wrong approach. Indeed, if Regulation SCI had been in place, we believe that the systems issues noted above for the exchanges likely would have still occurred. Layering costly technology regulation on market venues is not a panacea and the costs that Regulation SCI would impose would far outweigh the incremental benefits that may come from the rule. ITG maintains that the markets would be better served through the fair and consistent enforcement of existing rules and regulations (*e.g.*, Exchange Act Rule 15c3-5) rather than the creation of new regulatory obligations.

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[4] *See* 17 CFR §240.15c3-5.

III. Regulation SCI is Flawed: Its Overreaching and Unduly Burdensome Provisions Fail to Accomplish the Commission's Objectives

A. Overly Broad Definitions of Regulation SCI Terms

ITG believes that proposed Regulation SCI has three main problems. First, the proposal contains overly broad or vague definitions of key terms, such as SCI entity, SCI system, SCI security system, and SCI event. For example, Regulation SCI would define the term "SCI systems" to mean "all computer, network, electronic, technical, automated, or similar systems of, or operated by or on behalf of, an SCI entity, whether in production, development, or testing, that directly support trading, clearance and settlement, order routing, market data, regulation, or surveillance." The SEC indicates that the definition of "SCI system" could encompass systems of third parties operated on behalf of an SCI entity and systems that are unrelated to the trading operations of an ATS.

As discussed more fully below, the term "SCI entity" would cover far too many entities. The volume thresholds for an ATS to be an SCI entity are far too low and would result in capturing many ATSs whose systems do not have a significant marketplace impact.

The term "SCI security systems" is also broadly defined as "any systems that share network resources with SCI systems that, if breached, would be reasonably likely to pose a security threat to SCI systems." The SEC provides examples of the types of systems that may be encompassed: systems that are typically accessed by users, such as employees or corporate executives, that are authorized to view non-public information. The systems could include administrative services, email capability, intranet sites, financial and accounting systems and systems that support web-based services. The SEC also notes that systems that an SCI entity utilizes to provide a service to participants or clients, such as transaction services, infrastructures services and data services, may be covered if they provide a point of access and, therefore, share network services to an SCI entity's SCI systems.

The term "SCI event" is also extremely broad, and would encompass all systems disruptions, compliance issues[5] and intrusions. The term "systems disruption" is also

[5] Systems compliance issues would include events causing an ATS's SCI systems to operate in a manner that does not comply with the ATS's governing documents or the federal securities laws. *See* Proposing Release at 72.

overly broad and includes a "significant back-up or delay in processing" or a "significant diminution of ability to disseminate timely and accurate market data." It also includes a "loss of use of any such system." The SEC indicates that the definition would even include instances where a primary trading or clearance and settlement system fails and is immediately replaced by a backup system "without any disruption to normal operations." Systems disruptions also include, among other things a "loss of use of any such system" with no reference to a period of time. In addition, for certain "dissemination SCI events," the ATS will have to provide information to the public concerning systems intrusions, systems compliance issues and any system disruptions that "results, or the SCI entity reasonably estimates would result, in significant harm or loss to market participants."

When aggregating these concepts, the proposed regulation would subject virtually all the systems of far too many marketplace entities to an enormous array of regulatory requirements. There is no plausible justification for extending the SEC's authority to regulate the technology in minute detail of dozens of entities.

B. *Unduly Burdensome Costs for Industry and Misallocation of Resources for Commission Staff*

In addition to its overly broad scope, the proposal would cause SCI entities to allocate a tremendous amount of resources toward compliance without any real benefit to the marketplace. ITG's concern is that Regulation SCI would force ATSs to adopt detailed and costly policies and procedures, notify the SEC of systems disruptions, issues, intrusions, and material systems changes, engage in industry testing, and provide the SEC staff with access to its systems, among other requirements. Compliance with each of these would involve a substantial allocation of staff resources and time. Indeed, the requirements are so encompassing that they would almost de facto regulate ATSs as SROs, with rule filing-like notifications and micro management by the SEC of their systems. SRO-like systems regulation would raise significantly the costs of operating an ATS and place obstacles and delays to systems changes. Yet, the purported SEC goal of enhancing the systems security, capacity, and integrity of these systems is an illusory concept because, as noted above, ATSs have not been the source of systems issues and they have a vested self-interest in promoting their systems security, capacity, and integrity. Imposing Regulation SCI on ATS likely would not result in any meaningful improvements in these areas but would impose unduly burdensome costs.

It should be noted that the regulation would also result in a misallocation of Commission resources in ensuring compliance with Regulation SCI and responding to the deluge of notifications it would receive. If, as the Commission estimates, 44 entities

would meet the definition of SCI entity, then the SEC would have to devote a large, full time staff to overseeing SCI compliance. The SEC staff resources needed for this would dwarf those used for the ARP program in the past. Regulation SCI almost certainly would result in daily notifications from one or more SCI entity, which notification would have to be analyzed and acted upon by the SEC staff. Similarly, the SEC staff would have to devote significant additional resources to reviewing the system change notifications from the 44 entities that would be subject to the regulation. Moreover, substantial examination resources from the SEC and FINRA would be assigned to Regulation SCI oversight.

The benefits from all this activity are likely to be marginal, as neither the SEC nor any government regulator can regulate with 100% assurance that systems issues will not occur. Indeed, we believe that it is likely that Regulation SCI would not reduce in a material manner the occurrence of systems issues at SCI entities. As discussed below, we think the SEC staff resources would be better devoted to working with the industry to develop best practices (not legal requirements) for all regulated entities to follow in the areas of systems capacity, security, and integrity.

In terms of costs, ITG believes that the SEC substantially underestimates the compliance costs associated with Regulation SCI. Specifically, the SEC estimates that an SCI entity's initial costs will be approximately between $400,000 and $3 million in initial costs and approximately between $267,000 and $2 million in annual costs.[6] These estimates are imprecise in terms of the man power and monetary costs that ATS operators, such as ITG, would be required to shoulder in order to implement and maintain the large breadth of requirements of Regulation SCI. Although the proposing release attempts to quantify the costs associated with the rule, ITG believes that the SEC's estimates do not adequately account for the opportunity costs of delays in systems innovation and the immense monitoring and notification costs that would be engendered by the proposal. In addition, the Commission has not addressed the significant costs of complying with the requirements concerning the capacity, integrity, resiliency, availability, and security of SCI systems. Specifically, proposed Rule 1000(b)(1)(i)(E) requires SCI entities to establish business continuity and disaster recovery plans that include maintaining backup and recovery capabilities sufficiently resilient and geographically diverse to ensure next day resumption of trading and two-hour resumption

[6] The SEC indicated that when aggregated, the total costs for the 44 SCI entities are approximately between $17.6 million and $132 million in initial costs and $11.7 million and $88 million in annual costs. *See* Proposing Release at 327 and 330.

of clearance and settlement services following a wide-scale disruption.[7] ITG maintains robust redundant and backup systems that exceed regulatory requirements and provide adequate capacity, security, and resiliency for our trading operations. However, the man power and financial capital required to maintain and staff a geographically diverse backup site would easily push ITG's annual and recurring compliance costs far beyond the higher estimates provided by the Commission.

The SEC's substantial underestimate of compliance costs also includes the cost of lost business opportunities and the inability to swiftly deploy corrective solutions caused by the system change notification requirements. Currently Regulation ATS requires ATSs to provide the SEC with an amendment to Form ATS at least 20 calendar days prior to implementing a material change to the operation of the ATS. This has proven to be somewhat of an implementation drag on ATSs, as an ATS has to build into its development schedule the 20 day notification period. It is common for an ATS to finalize the systems specifications for a change close to when the ATS wants to go live with the change. However, it must wait 20 days so that the SEC can review notice of the change. Occasionally, the SEC staff will notify the ATS of questions or issues the staff has with the proposed change, which can further delay implementation. The proposal would lengthen the notification requirement, absent exigent circumstances, to 30 calendar days, and broaden it to include any significant systems change, not just a material change to the operation of the ATS.

Most ATS operators with advanced systems purposefully implement frequent agile modifications instead of major episodic changes in order to continuously improve their systems and minimize the impact of the changes. A built-in 30 day delay in implementing these changes would stifle timely systems innovation or system fixes. The proposed notification requirements would eliminate an ATS operator's ability to make frequent agile changes, thereby encouraging the deployment of larger, riskier changes more infrequently – creating longer periods of time, during which a system issue and/or erroneous configuration could continue without correction.

In view of current practices employed by major ATS operators, the notification process has the potential to delay the deployment of corrective solutions that are necessary to ensure the provision of uninterrupted and efficient order matching services at the best available prices. Furthermore, this proposed requirement could create huge lost business opportunities for ATSs while yielding little to no benefit, as ATSs have not

[7] *See* Proposed Rule 1000(b)(1(i)(E).

been subject to such a process and yet have not experienced systems change issues that have negatively impacted the marketplace.

C. Arbitrary and Capricious Application of Regulation SCI to ATSs

Finally, proposed Regulation SCI unfairly discriminates against ATSs in its coverage. Regulation SCI is intended to address systems issues of key marketplace entities. Yet, the proposal does not cover clearing firms, market makers, block positioners, and order routing firms, among others. In many ways, a technology failure at one of these entities would have a more immediate and pronounced impact on marketplace stability than a systems problem at a dark pool that executes 5% of the volume in a single NMS security. The proposing release for Regulation SCI does ask a question as to whether the proposal should be extended to a wider group of broker-dealers. ITG is not suggesting that the way to fix the proposal is to include many more entities, as that would simply increase the costs to the industry and further overwhelm the resources of the SEC. Rather, the failure to include these entities while capturing many ATSs demonstrates the arbitrary, capricious, and unfairly discriminatory nature of the rule, despite the Commission's sound objectives.

In light of the issues discussed above, ITG respectfully requests that the Commission significantly revise several provisions of proposed Regulation SCI. Specifically, the SEC should develop a less costly and less intrusive set of systems requirements that would apply only to those marketplace entities that are of significant systemic importance. We discuss below how such a substantially revamped proposal would operate.

IV. Proposed Revisions to Scope of Regulation SCI and Definition of SCI Entity

A. Modified Volume Thresholds for ATSs to Qualify as SCI Entities

ITG's main recommendation is that the SEC revise proposed Regulation SCI so that it only applies to marketplace entities whose systems problems would result in an immediate and substantial impairment of a functioning marketplace. Only the coverage of these types of entities could justify the huge costs and burdens that would be imposed by the regulation. Accordingly, ITG believes that the volume thresholds for determining which market centers qualify as SCI entities should be modified significantly. The following contains the proposed volume thresholds under Regulation SCI and our proposal for modified thresholds:

	Average Daily Dollar Volume Thresholds Proposed under Regulation SCI	ITG's Proposed Average Daily Dollar Volume Thresholds
SCI Alternative Trading Systems	(1) 5% or more of any single NMS stock and 0.25% or more of all NMS stocks for 4 of the previous 6 months;[8] **OR** (2) 1% or more of all NMS stocks in 4 of the previous 6 months.	(1) 5% or more of at least 5 NMS stocks with an aggregate average daily share volume[9] greater than 500,000 shares and 0.25% or more of all NMS stocks for 4 of the previous 6 months; **OR** (2) 3% or more of all NMS stocks in 4 of the previous 6 months
Exchanges	All exchanges qualify as an SCI entity.[10]	5% or more of at least 5 NMS stocks for 4 of the previous 6 months.

Without the above volume threshold revisions, it is possible for an ATS to be covered under Regulation SCI, even if its average daily dollar volume is less than $50,000 a month for four of the previous six months in a single relatively low volume NMS stock.[11]

For entities that do not meet the standard for constituting an SCI entity under our proposed revisions, the Commission could still play an important role in promoting marketplace stability without the need for regulation. Specifically, the SEC could use its experience in the ARP program and, in the future, applying the revamped Regulation SCI, to work with the industry to develop a set of best practices for all regulated entities, including broker-dealers and investment companies. The best practices would not be regulatory requirements but rather guidance for regulated entities to take into account when addressing systems capacity, integrity, and security issues. Specifically, the

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[8] *See* Proposed Rule 1000(a).

[9] For purposes of this letter, the term "aggregate average daily share volume" will have the same definition as provided under Rule 301(b)(3)(B) of Regulation ATS. *See* 17 CFR §242.301(b)(3)(B).

[10] *See* Proposed Rule 1000(a).

[11] ITG understands that under the current proposal, the ATS would also have to execute 0.25% of the average daily dollar volume of all NMS stocks for four of the previous six months to be covered under Regulation SCI. *See* Rule 1000(a) of proposed Regulation SCI. This is such a low percentage that it would capture ATSs that have no real impact on the national market system.

guidance could suggest best practices for: (1) deployment and testing of systems; (2) industry wide testing under simulated market conditions; (3) ensuring quick recovery from systems failures; and/or (4) responding to disruptive and/or catastrophic market events.

B. Reduced Obligations for Lesser SCI Entities

If the SEC chooses not to raise the volume thresholds for determining an SCI entity as recommended above, then ITG recommends that the Commission bifurcate the proposal so that the entire provisions of the regulation apply only to the most important entities while a reduced set of provisions apply to lesser SCI entities. The reduced set of provisions would include only a scaled-down set of policies and procedures and eliminate notification requirements. For example, the SEC could apply all of Regulation SCI to SROs, clearing agencies, and plan sponsors and an "SCI-Lite" version to ATSs, clearing brokers, and market makers. Another means of stratification could be on the basis of market impact. For example, entities that meet the volume thresholds we recommend above would be subject to a complete Regulation SCI while entities that meet the SEC's proposed thresholds would be subject to an SCI-Lite regulation. A third means of differentiation could be based on market transparency, as is done now in Regulation ATS. Entities that posted quotes in the public quote stream or to other entities, such as exchanges, the Alternative Display Facility, and Electronic Communications Networks would be subject to Regulation SCI while other SCI entities would be subject to SCI-Lite.

Our strong preference is our first recommendation, that the SEC adopt a modified volume threshold for becoming an SCI entity that partially excludes NMS stocks with low average daily share volumes from the threshold calculation process. This measure would limit the rule to those entities truly having a potential for a significant systemic impact on the maintenance of fair and orderly markets. If the SEC chooses not to take this option, then differentiation among SCI entities along one of the approaches we suggest above would at least make the regulation more closely aligned to the actual market impact of the entity involved.

V. Proposed Modifications to Regulation SCI Obligations and Definitions

A. Definition of SCI Systems and SCI Security Systems

Aside from our main recommendation discussed above, ITG believes that several other areas of proposed Regulation SCI require substantial modification. First, the SEC

needs to clarify many vague or broad terms in the regulation, including SCI system, SCI security system, SCI event and dissemination SCI event. For example, the SEC indicates that the definition of "SCI system" could encompass systems of third parties operated on behalf of an SCI entity. The breadth of this definition is enormous and could include a number of vendors that provide services to ATSs, such as those that provide automated recordkeeping or execution algorithm services. Moreover, the term "SCI security system" is overly broad and appears to encompass almost every system at an ATS. For example, it is unclear whether an email disruption would constitute a disruption in the SCI security system requiring notification. We believe that the definition of SCI security system should include only those systems that are materially and directly connected to the trading operations of the ATS and/or exchange. ITG would interpret this standard to cover systems used by an SCI entity for order handling and execution, processing of market data, transaction reporting, and clearing and settlement of trades.

The vague definition of "SCI event" is also troublesome and could be read as a disruption lasting only a few seconds requiring notice to the SEC. In addition, there are many interpretative thresholds in the regulation that need quantifying. For example, without further clarification, ATSs will have to devote substantial resources to determine when a "significant back-up or delay in processing," "significant diminution of ability to disseminate timely and accurate market data" or "significant harm or loss to market participants" has occurred and to address each and every case in accordance with the regulation's notification requirements.

B. Notification Requirements

In addition to re-defining key terms, the proposal should overhaul the instances where an SCI entity must notify the Commission of an SCI event by applying a risk-based approach that is tailored to the potential impact of the event. For example, a systems outage that shuts down trading of the NYSE or NASDAQ for two hours has far more market impact than a two hour trading cessation of a dark pool. In this regard, the SEC should consider implementing the term "material SCI event", thereby reducing the notification requirement to those events that have a material impact on the ongoing maintenance of fair and orderly markets in an NMS security. Those are the type of events that might warrant prompt SEC review. There is no valid reason to require an SCI entity to report all systems disruptions, system compliance issues, and systems intrusions. The reduction in notifications would lessen the costs of the regulation, reduce the over-reporting of events, and free up SEC staff to focus on the systems events that truly warrant regulatory review.

In defining a "material SCI event", ITG proposes that the SEC consider factors such as overall market disruption, length of time of the event, financial impact, and the inability to meet core regulatory obligations regarding order handling and execution activities (*e.g.*, Regulation NMS, Regulation SHO, Best Execution, Manning Rule, Limit Up – Limit Down, Transaction Reporting for Media, Trading Halts, etc.). Based on an analysis of the above factors and ITG's own experiences, the Firm maintains that a seamless fail-over of a system that does not result in any material disruption to the handling and/or execution of customer orders should not qualify as a "material SCI event."

Rules 1000(b)(4) and (5) require an SCI entity not only to notify the Commission but also to disseminate information whenever it becomes aware of an SCI event and/or SCI dissemination event.[12] This obligation could be counterproductive and actually harmful to the markets by forcing ATSs and exchanges to release information concerning a particular systems issue before all of the relevant facts, causes, and/or potential solutions are known. As a result, market participants, investors, and/or regulators could receive inaccurate and/or incomplete information concerning an SCI event. Accordingly, ITG proposes that the Commission modify Rules 1000(b)(4) and (5) to require dissemination only for "material SCI events", as defined by the above mentioned factors. In addition, the obligation to disseminate information regarding the material SCI event would be triggered when an SCI entity reasonably determines that it has acquired credible information that can be acted upon.

ITG also asserts that the SEC notification requirement for material modifications to SCI systems should be eliminated. The rationale for this requirement is to help ensure that the Commission has information about important changes at an SCI entity that may affect the SCI entity's ability to effectively oversee the operation of its systems. This overly prescriptive rationale presumes that the Commission needs to manage the systems modification process at SCI entities. This would extend the SEC's reach far beyond that of a securities regulator and instead enable it to regulate the IT process of marketplace participants. The Exchange Act provides the Commission with the authority to review proposed rule changes of SROs. It does not enable the SEC to bootstrap its SRO rule review authority or its national market system authority to force regulated entities to submit upcoming material systems changes for agency approval. As discussed above, this requirement would stifle new systems development and insert the Commission into the technological decision making of SCI entities. That is not the proper role for the

[12] *See* Proposed Rule 1000(b)(4) and (5).

Commission nor is it justified under the Exchange Act. Instead, the Commission need only receive notifications when they are a significant part of proposed rule changes by SROs or amendments to Form ATS of material changes to the operation of the ATS.

C. Safe Harbor

We also maintain that Regulation SCI's safe harbor provisions require substantial revision. The SEC proposes a safe harbor from the requirement in Regulation SCI that an SCI entity's policies and procedures be designed to ensure that the SCI systems operate in the manner intended. First, the requirement of assurance that an entity's systems operate in the manner intended is problematic by itself. No set of policies and procedures can guarantee 100% operational compliance. Historically the SEC has allowed firms to use a reasonableness standard so that policies and procedures are required to be reasonably designed in a manner to promote compliance, and in fact a reasonableness test is used in the safe harbor. The same should be used for the underlying predicate requirement in Regulation SCI. Second, the proposal would qualify an entity for the safe harbor if it established and maintained certain policies and procedures relating to the: (1) testing of SCI systems and changes; (2) internal controls over changes; (3) ongoing monitoring of system functionality; (4) compliance assessments and regulatory personnel review of SCI systems and system changes; and (5) testing and controls to prevent, detect, and address actions that are not in compliance with the federal securities laws and with the entity's rules and/or governing documents. The safe harbor contains so many requirements that it operates as a rule by itself. There is a real potential for the safe harbor provision turning into a de facto requirement, such that if an SCI entity does not satisfy the specified requirements of the safe harbor, it could be in violation of the regulation. Moreover, the safe harbor's requirement of review by regulatory personnel of SCI systems unreasonably exposes non-technology persons to potential liability if an SCI system suffers a malfunction.

ITG recommends that the SEC simplify the safe harbor. The safe harbor only should require that an SCI entity adopt reasonable policies and procedures for adhering to the regulation, which should include reasonable testing of systems changes and reasonable ongoing monitoring of system functionality. These are the appropriate obligations that a securities regulator should impose on regulated entities with respect to their systems. Anything more would position a securities regulator as a micromanager of the internal technology of regulated entities. That is not a role the SEC should assume nor is it one that is consistent with the Exchange Act.

D. Business Continuity Planning

Further to the point above concerning the dangers of the SEC becoming a technology czar, the SEC should remove from Regulation SCI the business continuity plan requirements and system testing requirements for any ATS deemed to be an SCI entity. Regarding the business continuity plan and system testing requirements, the SEC, through Regulation SCI, should focus on the entities that are systemically critical participants to the infrastructure of the marketplace, such as primary listing exchanges, securities information processors, and clearing agencies rather than broker-dealer ATSs, which merely provide trading facilitation services. As broker-dealers subject to FINRA regulation, ATSs are already required to implement business continuity plans in connection with emergencies or significant business disruptions. The plans must be reasonably designed to meet existing obligations to customers and address existing relationships with other broker-dealers and counter-parties under FINRA's rules. These plans are subject to regular examination by FINRA and the SEC. ATSs should not be held to the same standards as entities such as primary listing exchanges and be required to have "backup and recovery capabilities sufficiently resilient and geographically diverse to ensure next day business resumption of trading." Moreover, requiring an ATS to resume clearance and settlement services within two hours is an insufficient amount of time.

E. Testing of ATS Systems with Mandatory Subscriber Participation

We also believe that the SEC is being overzealous in requiring ATSs, which have no regulatory authority over their subscribers, to participate in mandatory systems testing at least once a year. Most ATSs allow their subscribers to voluntarily participate in the testing of their systems. Regulation SCI, however, would require that ATSs designate, and notify the SEC of, subscribers to participate in functional and performance testing of the operation of the ATS's business continuity and disaster recovery plan. The designees would have to participate in the testing at least once every twelve months. The testing will be costly to both the ATSs and their investor subscribers. The SEC estimates that the total costs to participants will be $66 million ($10,000 per participant) annually.[13] While $66 million is so high by itself as to pose an unreasonable cost, we believe the real cost would be even higher.

The SEC's estimate is based on the fact that many participants would have connectivity and, therefore, incur a minimal cost. We believe this calculation is an

[13] *See* Proposing Release at 332.

underestimate because of the time, resources, and professional staff that would be devoted to the testing process and the resulting lost business opportunities associated with the inability to focus on revenue generating projects. In addition, while connectivity between an ATS and its subscribers may already be established, additional configurations and build out of systems may be required to create a testing environment that simulates live market conditions. Considering these factors in the aggregate, the total annual costs for a single participant could easily exceed $10,000. Moreover, ATSs have no regulatory authority over their subscribers. If a subscriber does not wish to participate in a test, the subscriber can terminate its subscription, causing potential costly harm to the ATS. In sum, industry-wide testing would be cost prohibitive and extremely difficult to organize logistically.

F. SEC Access to SCI Systems and SCI Security Systems

ITG also believes that the requirement to provide SEC with access to systems should be eliminated. Proposed Rule 1000(f) would require SCI entities to provide Commission representatives with reasonable access to their SCI systems and SCI security systems. This would facilitate the access of Commission representatives to such systems *either remotely or on site.* This requirement is intended to ensure that the SEC has ready access to SCI systems and SCI security systems to evaluate an SCI entity's practices with regard to the requirements of Regulation SCI. This requirement is flawed for many reasons. First, the concept of reasonable access is vague. For example, it is unclear whether access must be provided upon request or at the SEC's own initiative. Furthermore, the proposed rule could require real time "keyboard access" to SCI systems and security systems. ITG is not aware of any instance where the SEC has direct and real-time access to the systems of regulated entities. Second, such access could present significant risks to such systems, as the SEC could inadvertently introduce viruses, bugs, or other unintended malware into the systems. Third, if the SEC had access to the production or test/development systems, there is a risk that the SEC representatives could inadvertently impact the systems. Moreover, such access would be an unprecedented intrusion of a regulator and law enforcement agency into the ongoing operations of an SCI entity. Finally, providing SEC officials with open access could result in unauthorized breaches of SCI systems and SCI security systems that could lead to substantial harm to exchanges, broker-dealers, ATSs, customers, securities information processors, clearing agencies, and the U.S. markets, which is the type of activity that the proposed rule seeks to prevent. The stated intent of the SEC in proposing this provision – Regulation SCI compliance – does not justify remote or immediate access. For all of these reasons, this requirement should be eliminated.

VI. Conclusion

ITG deeply respects the SEC's legitimate interest in the capacity, integrity, and security of key systems of important marketplace entities. Nevertheless, proposed Regulation SCI goes far beyond the boundaries of this interest, and should therefore be substantially scaled down and simplified. The standards for its application should be modified to apply only to entities with major marketplace impact and a significant reduction of the technical and detailed requirements of the proposal is needed. Furthermore, its notification requirements should be reduced or eliminated. Without these changes, Regulation SCI would pose more harm to the marketplace and induce far more costs than the limited benefits it might provide to the SEC.

ITG appreciates the opportunity to comment on proposed Regulation SCI. If you have any questions, please contact us.

Sincerely,

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