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January 23, 2009

Sent via rule-comments@sec.gov

Ms. Florence E. Harmon
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Release No. 34-59163 (SR-NASDAQ-2008-097): Notice of Filing of Proposed Rule Change by The NASDAQ Stock Market, LLC Adopting a Limited Exemption from OATS Order Data Recordation Requirements for Registered Options Market Makers

Dear Ms. Harmon:

Wolverine Execution Services, LLC (“Wolverine” or “Firm”) appreciates the opportunity to comment on the above rule proposal submitted by The NASDAQ Stock Market, LLC (“NASDAQ” or “Exchange”). Specifically, NASDAQ proposes to adopt a limited exemption from the requirements of the Order Audit Trail System (“OATS”) rules¹ for registered options market-makers. Overall Wolverine commends the Exchange for their efforts to further reduce the burden of reporting requirements of member firms by recognizing such orders do not directly contribute to the purpose of OATS; however, the Firm believes this exemption illustrates the regulatory inconsistencies that now exist, and that will be further exasperated through adoption of this exemption only by NASDAQ. In general, Wolverine respects NASDAQ’s need to detect and deter market manipulation of customer orders; however, the Firm believes the intentions of OATS have long been lost through the complex regulatory framework that has evolved since the approval of the OATS rules more than a decade ago.

As the staff of the Securities and Exchange Commission (“Commission”) is aware, NASDAQ was granted approval² as a national securities exchange and in 2006, and in doing so, adopted a rulebook substantially similar to that of the National Association of Securities Dealers, Inc. (n/k/a Financial Industry Regulatory Authority, Inc.) (“NASD” or “Association”) including the audit trail rules for OATS. Wolverine understands that the rules of NASDAQ are substantially similar to those of NASD for three primary reasons: (1) NASD rules were designed to govern the original NASDAQ (over-the-counter) trading platform and its participants, (2) adoption of such rules would assist in the approval of NASDAQ’s application as a national securities exchange without further unnecessary delay and (3) NASDAQ’s allocation of the regulatory oversight for the membership, sales practice, and operational requirements of “dual member” firms to the NASD through execution of an agreement³ pursuant to Commission Rule 17d-2 following its

¹ See NASDAQ Rule 6950, *et seq.*

² See Securities Exchange Act Release No. 53128 (File No. 10-131), 71 FR 19763 (April 17, 2006).

³ See Securities Exchange Act Release No. 53628 (File No. 4-517), 71 FR 3350 (January 23, 2006).

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approval as an exchange. Despite these arguments for adopting OATS rules, we believe such duplication is unnecessarily burdensome and complex within the industry and must be re-addressed by NASDAQ, FINRA and the Commission.

OATS History

Prior to NASDAQ's approval as an exchange, NASDAQ was owned and operated by NASD. During this period of ownership, NASD was subject to an enforcement action and related settlement by the Commission staff in part for NASD's "failure to adequately enforce its rules,"⁴ which, among other matters, included inefficient surveillance of its marketplace (e.g., NASDAQ). To comply with the settlement terms, NASD proposed the rules establishing OATS and set forth an implementation schedule to phase-in the system; however, this solution clearly placed the burden of compliance on member firms rather than improving upon internal trade data available to the Association.⁵ In its filings with the Commission, NASD stated that OATS would document the "life of the order."⁶ NASD further contended that non-electronic (e.g., telephone) orders and transactions were "a significant part of the activity in the NASDAQ market"⁷ and that documentation related to such non-electronic orders was essential to adequately conduct market surveillance. Despite the volume of manual orders and the need for enhanced surveillance, NASD proposed, and the Commission approved, the ability of member firms to only submit limited information for manual orders to OATS as "these information items generally correspond to data that is expected to be readily available ...at the time the [manual] orders are received." The Commission based this decision on "unique challenges" OATS presented to member firms to handle manual orders.⁸

Notwithstanding the settlement requirements, NASD (1) limits the applicability of OATS to NASDAQ-listed securities, as opposed to all securities available for execution on NASDAQ and (2) excludes proprietary (dealer) orders of FINRA-registered market-makers.⁹ In consideration of the former, NASDAQ was, at the time of OATS implementation, the primary venue¹⁰ for trading NASDAQ-listed securities. For the latter, Wolverine specifically highlights the fact that the rule proposal and related Approval Order noted the frequency of member firms "backing away" or failing to adhere to "firm quote" requirements as a primary need to improve upon

⁴ See In the Matter of National Association of Securities Dealers, Inc., SEC Release No. 34-37538, August 8, 1996; Administrative Proceeding File No. 3-9056 ("SEC Order").

⁵ By comparison, Wolverine notes the lack of similar requirements by other market centers to provide order information on a daily basis.

⁶ See Securities Exchange Act Release No. 39729 (SR-NASD-97-56), 63 FR 12559 (March 13, 1998).

⁷ *Id.*

⁸ *Id.*

⁹ See FINRA Rule 7410(j).

¹⁰ Today, trading of NASDAQ-listed securities is conducted on multiple national securities exchanges, including: NYSE Arca; International Securities Exchange; Chicago Stock Exchange; National Stock Exchange; BATS Exchange; CBOE Stock Exchange; and certain facilities of the New York Stock Exchange (e.g., Matchpoint).

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NASD's surveillance capability; however, such violative practices are commonly attributed by FINRA to dealers,¹¹ not firms that would be and are subject to OATS reporting.

Increasing Complexity of OATS Reporting

Since its inception, OATS has undergone frequent changes and, on average, has been modified every four months since November 2005,¹² not considering related addendums. These changes are intended to reflect the increasingly complex order structure that exists within the marketplace; however, we believe these changes more commonly lead to member firms being accused of and charged with violations of the OATS recording requirements rather than contributing to FINRA's ability to conduct more effective surveillance. To illustrate this increasing complexity, the November 11, 2005, OATS Technical Specifications listed five (5) possible 'Destination Codes'¹³ and twenty-four (24) 'Special Handling Codes.' By comparison, the December 15, 2008, OATS Technical Specifications identify nineteen (19) 'Destination Codes' and sixty-one (61) 'Special Handling Codes.' Alarming, these data fields represent only two of the ninety-four (94) fields that may be required for OATS compliance of any single reportable event, and contribute to the inability of so many member firms to properly comply.¹⁴ Although Wolverine does not dispute that OATS must contribute to the surveillance of member trading practices, the Firm believes the burden placed on member firms far outweighs any regulatory benefit.

Regulatory Overlap and Overreaching

As discussed above, OATS was initially developed by NASD as a surveillance tool for activity on its facilities. Over the past ten years, the number and volume of NASDAQ-listed securities has grown significantly, as has the number of market centers that trade these securities.¹⁵ Despite the requirement to report information to OATS regarding any equity security listed on NASDAQ, and that the intention of OATS is for record the "life of an order," consideration has not been made as to the validity or necessity of member firms to report transactions on market

¹¹ See FINRA Interpretive Material 3320, which states in relevant part, "[i]n some instances a dealer's quotations, purportedly firm, are, in fact, so qualified upon further inquiry as to constitute 'backing away' by the quoting dealer. Further, dealers who place quotations in the sheets have been found to be unwilling to make firm bids or offers upon inquiry in such a way as to pose a question as to the validity of the quotations originally inserted. Such "backing away" from quotations disrupts the normal operation of the over-the-counter market."

¹² An archive of prior Technical Specifications for OATS is available through FINRA's website: <http://www.finra.org/Industry/Compliance/MarketTransparency/OATS/TechnicalSpecifications/p016707>. It should be noted this website does not include any versions prior to November 11, 2005.

¹³ Destination Codes represent possible market centers to which orders for NASDAQ-listed securities may be sent for execution.

¹⁴ The 2008 FINRA Monthly Disciplinary Actions identify thirty-seven member firms that were found to be in violation of OATS reporting requirements. These member firms represent some of the prominent registered broker-dealers within the industry conducting business with the public, including Goldman Sachs & Co., Merrill Lynch, UBS, and J. P. Morgan, and illustrates that firms with extensive technical resources are unable to interpret, implement and/or maintain OATS reporting requirements.

¹⁵ See *supra* Note 10.

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centers other than NASDAQ (e.g., NYSE Arca). Again, Wolverine references the nineteen (19) ‘Destination Codes’ available for use in the Technical Specifications, yet only three (3) (Member, ECN, or NASDAQ) relate to entities that may contribute to the full audit trail.

Following the separation of NASDAQ from NASD ownership, NASD retained its full OATS requirement for the reporting of orders of NASDAQ-listed securities, and only NASDAQ-listed securities, irrespective of the fact that NASDAQ is no longer a facility of the Association. Despite two self-regulatory organizations requiring essentially the same information, Wolverine is aware of only one OATS platform or database to which all related information is submitted daily. Shortly after NASDAQ’s regulatory independence, the Exchange received approval¹⁶ to grant an exemption from the OATS reporting requirements for proprietary orders its member firms. This action confirms information previously submitted to OATS under NASD rules did not immediately contribute to the full audit trail, nor is this information needed on a daily basis. This action also created the first significant discrepancy between the NASD and NASDAQ rules governing OATS. Further separation and distinction of a regulatory system(s) designed for the same purpose may only lead to regulatory gaming between market participants that do not conduct business with the public.

Summary

As the Commission has stated, and recent NASDAQ exemptions confirm, OATS was designed for “customer protection through transparency of the execution of customer orders.” Yet, this purpose is lost through the complexity of information required to be submitted to OATS daily or to be submitted by any firm not conducting business directly with the public.¹⁷ Wolverine applauds the Commission’s, NASD’s and NASDAQ’s efforts to ensure a fair and orderly marketplace, but we strongly disagree with the use of the manner in which industry participants must adhere to these requirements through the use of OATS, a system that has outlived its usefulness in consideration of the advancement of electronic trading and capturing of such information.¹⁸

Furthermore, Wolverine believes the proposed exemptions to OATS should not be limited to orders of proprietary trading firms or options market-makers, but should be extended or apply to any order which is not for or on behalf of a customer. Additionally, we recommend that all

¹⁶ See Securities Exchange Act Release No. 56096 (SR-NASDAQ-2007-037), 72 FR 40917 (July 25, 2007). See also Letter from Greg O’Connor, Chief Compliance Officer, Archipelago Securities, LLC, to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, dated July 30, 2007, regarding Securities Exchange Act Release No. 56096.

¹⁷ Section 15(b) of the Securities Exchange Act of 1934, and Rule 15b91(a)(2) promulgated thereunder requires any broker or dealer conducting business with the public to register with a registered national securities association (e.g., FINRA).

¹⁸ See *supra* Note 6. In its filing, the NASD noted the Commission’s inability to retrieve documentation from over-the-counter trading desks. As noted above, the NASDAQ system for over-the-counter trades was primarily a manual marketplace. OATS was designed, in large part, to address this inadequate record keeping of manual transactions rather than address member firms’ compliance with Commission Rules 17a-3 or 17a-4.

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OATS information be provided to NASDAQ or FINRA on an as-needed basis, rather than daily. Too often, member firms experience system issues and may be unable to provide information to OATS within the time period prescribed. Although FINRA may not initiate enforcement action based on such issues when proper supervisory procedures are in place to detect and report an issue in a timely manner, this no less demonstrates that OATS must routinely have an inaccurate or incomplete audit trail on any given reporting day.

Overall, we view FINRA's use of OATS as an impediment to the mechanism of the national securities market system and is a requirement that is neither reasonable nor effective. In consideration of our comments, we strongly urge the Commission to (1) approve the options market maker exemption proposed by NASDAQ and (2) encourage the NASD and NASDAQ to harmonize rules applicable to OATS. We thank the Commission for the consideration of our comments, and welcome the opportunity to discuss this matter further.

Best regards,



Greg O'Connor
 Compliance Manager

cc: James Michuda, Chief Executive Officer – Wolverine
 Megan Flaherty, Chief Legal Counsel – Wolverine