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SECURITIES AND EXCHANGE COMMISSION (SEC)

**17 CFR Parts 240 and 249**

**[Release No. 34-33605; File No. S7-3-94]**

**RIN 3235-AG03**

**Recordkeeping and Reporting Requirements for Trading Systems Operated by Brokers and Dealers**

Part VIII

59 FR 8368

**DATE:** Friday, February 18, 1994

**ACTION:** Proposed rulemaking.

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**[\*8368]**

**SUMMARY:** The Securities and Exchange Commission ("Commission") proposes Rule 17a-23 ("Rule") under the Securities Exchange Act of 1934 to establish recordkeeping and reporting requirements for brokers and dealers that operate automated trading systems. Registered broker-dealers sponsors of these systems would be required to maintain participant, volume and transaction records, and to report system activity periodically to the Commission. The Rule would provide the Commission with the information necessary to effectively monitor and evaluate these systems.

**DATES:** Comments must be received on or before April 19, 1994.

**ADDRESSES:** Comments should be submitted in triplicate and addressed to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Mail Stop 6-9, Washington, DC 20549. Comment letters should refer to File No. S7-3-94, and will be made available for public inspection and copying in the Commission's Public Reference Room, 450

Fifth Street NW., Washington, DC.

**FOR FURTHER INFORMATION CONTACT:** Gordon K. Fuller, Special Counsel, Sheila C. Slevin, Branch Chief, or Kristen N. Geyer, Attorney Advisor, 202/272-2067, Office of Automation and International Markets, Division of Market Regulation, Securities and Exchange Commission, room 5040 (Mail stop 5-1), 450 Fifth Street NW., Washington, DC 20549.

## **SUPPLEMENTARY INFORMATION:**

### **I. Introduction**

The Commission solicits comment on proposed Rule 17a-23 ("Rule") n1 under the Securities Exchange Act of 1934 ("Act"). n2 Rule 17a-23 would require specific recordkeeping and reporting by broker-dealer sponsors of screen-based automated trading systems ("Broker-Dealer Trading System," or "BDTS").

n1 17 CFR 240.17a-23.

n2 15 U.S.C. 78a et seq.

Under the Act, sponsors of BDTSs must register as broker-dealers, and, accordingly, are subject to the general recordkeeping and reporting requirements of Section 17 of the Act and the rules thereunder. While these rules require broker-dealers to keep records relating to general brokerage activity and provide the Commission and self-regulatory organizations ("SROs") access to those records, they do not require BDTS sponsors to keep records that separately identify transactions effected through an automated trading system or provide readily accessible summaries of system volume, identification of securities trading on such system, or descriptions of system operation. This lack of system-specific information makes it difficult for the Commission to evaluate the operation of BDTSs with regard to national market system goals, to monitor the competitive effects of these systems, to ascertain whether broker-dealer regulation remains appropriate for the operation of such systems, and to identify areas where monitoring of such systems may be improved and where SRO surveillance may be more appropriately tailored to the detection of fraudulent, deceptive and manipulative practices in an automated environment.

The Rule would establish a uniform recordkeeping and reporting structure for all broker-dealer sponsors of BDTSs and would provide prospective sponsors of BDTSs with certainty as to their responsibilities under the Act.

### **II. Existing Reporting and Recordkeeping by BDTSs**

Broker-dealers operate a variety of automated systems, not all of which would be considered BDTSs under the Rule. The Rule as proposed would apply to two types of automated systems: (1) Systems that automatically execute orders to buy or sell securities based on quotations of the system sponsor or its affiliates; and (2) systems that both automate the dissemination or collection of quotations, orders, or indications of interest, and provide a mechanism for matching or crossing orders (or for otherwise facilitating agreement between

participants to the basic terms of securities transactions through use of the system). This would include trading systems that have been referred to in previous Commission releases as proprietary trading systems ("PTSs"),<sup>n3</sup> as well as some automated trading systems operated by third market makers.

<sup>n3</sup> See Securities Exchange Act Release No. 26708 (April 11, 1989), 54 FR 15429.

Currently, BDTs are subject to Commission oversight through broker-dealer registration, recordkeeping, and reporting requirements in the Act. In addition, sponsors of a number of systems have obtained no-action letters as discussed below that require supplemental recordkeeping and reporting.

#### *A. Broker-dealer Requirements*

Like any other entity effecting securities transactions, sponsors of BDTs must comply with the broker-dealer registration requirements of the Act.<sup>n4</sup> As registered broker-dealers, sponsors are subject to Section 17(a) of the Act and rules thereunder, which require them to keep current records regarding their brokerage activity and to file certain reports with the Commission.<sup>n5</sup> These sponsors also are subject to oversight by an SRO,<sup>n6</sup> including inspection by the SRO of a sponsor's internal transaction records. These regulations require broker-dealers to record, maintain and make available to the Commission and the SROs information about any trade executed by a registered broker-dealer, including trades executed through BDTs, but do **[\*8369]** not require broker-dealers to keep records that present BDT activity separately from other brokerage activity, summarize system volume, describe securities trading on the system, or describe system operation and execution methods or to report such information on a regular basis in a usable format to the Commission.

<sup>n4</sup> The activities inherent in the operation of BDTs generally require the system sponsor to register with the Commission as a broker-dealer under Section 15 of the Act. Section 15(a) of the Act generally provides that a "broker" or "dealer" who uses the mails or any means of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of, any security must register with the Commission, unless an exemption applies. Section 3(a)(4) of the Act defines a "broker" as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." Section 3(a)(5) of the Act defines a "dealer" as "any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business." See sections 3(a)(4), 3(a)(5) and 15 of the Act, 15 U.S.C. 78c(a)(14), 78c(a)(15) and 78o. Cf. Letter regarding Security Pacific National Bank (July 19, 1985).

<sup>n5</sup> See, e.g., Rules 17a-3, 17a-4, 17a-5, and 17a-11 (17 CFR 240.17a-3, 17a-4, 17a-5, and 17a-11); and 17 CFR Parts 400-405, 449-450. Section 17(a) authorizes the Commission to require broker-dealers to make and keep such records and to make such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act, such as removing impediments to the national market system for securities and for the clearance, settlement, and safeguarding of securities and funds, and imposing requirements necessary to make such regulation and control reasonably complete and effective. 15 U.S.C. 78q(a).

n6 Registered broker-dealers that effect transactions in the over-the-counter ("OTC") market are required to become members of the National Association of Securities Dealers ("NASD"). 15 U.S.C. 78o(b)(8).

#### *B. No-action Letters*

The automation of a broker-dealer's order handling through BDTs often involves the use of order execution algorithms and methodologies that differ from traditional broker-dealer operations. Sponsors of these BDTs have requested and received assurances in the form of no-action letters from the Division that it will not recommend enforcement action if the system operates without registering as an exchange or other registered entity. n7

n7 The Division has issued no-action letters in this context to sponsors of 22 trading systems, 9 of which are operating currently. See letters regarding: Cantor Fitzgerald G.P. (October 1, 1993); Lattice Network (September 9, 1993); Crosscom Trading Network (November 24, 1992); Instinet Corporation's "Market Match" Crossing Session (December 6, 1991); LIMITrader (November 25, 1991); Franklin Advantage Crossing Networks (November 22, 1991); POSIT's Refined Pricing Feature (October 28, 1991); Exchange Services, Inc. (September 11, 1991), (May 22, 1985), and (September 5, 1985); Portfolio Trading Services, Inc. (May 16, 1991); Wunsch Auction Systems, Inc. (February 28, 1991); NYSAC (June 15, 1990); CapitaLink Bond Auctions, Inc. (December 11, 1989); RMJ Securities/Delta Government Options (January 12, 1989); ECON Investment Software (October 11, 1988); POSIT (July 28, 1987); Instinet (August 8, 1986); Security Pacific National Bank (July 19, 1985), (August 8, 1986); Robert L. Adler & Co. (August 7, 1985); NAPEX (August 2, 1985), (July 14, 1986); Troster Singer Corporation (May 23, 1985), (September 3, 1985); Transaction Services, Inc. (May 15, 1985), (September 5, 1985); and B&K Securities, Inc. (March 18, 1985), (September 5, 1985).

The 9 active BDTs which have been issued no-action letters are: (1) Instinet, which permits participants to enter indications of trading interest and permits other subscribers to execute against those indications of interest automatically through the System; (2) Instinet Crossing Network, a daily after-hours session to match trades for execution at the day's closing price on the primary market for exchange-listed stocks, and the mean of the closing inside bid and ask prices on NASDAQ for issues traded in the over-the-counter market. A subcomponent of the Crossing Network, Instinet Market Match, matches orders to buy securities in a session that occurs prior to the opening of trading on registered exchanges and NASDAQ, and subsequently executes the orders after the close of the day's regular trading at a volume-weighted average price; (3) POSIT, which provides order matching and execution of exchange-listed and OTC securities by institutional customers for single stocks or substantial securities portfolios. A subcomponent of POSIT, POSIT's Volume Weighted Average Pricing Session, matches participants' orders to trade equity securities prior to the opening of registered exchanges and the NASDAQ system and executes matched trades at volume-weighted average prices at the close of the day's regular trading on the exchanges and NASDAQ; (4) RMJ-Delta, which permits users of the system to effect trades on U.S. Treasury options through an intermediary or "blind broker," or on a fully disclosed basis through an automated communications network; (5) AZX, Inc., a single-price auction system that is an exchange operating pursuant to a so-called "limited volume" exemption; (6) CrossCom, which permits a network of subscribers linked by computers to enter bids and offers in high-yield and other fixed-income bonds to be matched and automatically executed by the System; (7) The Lattice Network, which facilitates trading in registered equity securities by combining order-routing and order matching features to execute transactions; (8) NAPEX, which gathers and disseminates indications of interest for registered limited

partnerships; and (9) a system operated by Cantor Fitzgerald G.P., which facilitates trading in limited partnership interest by displaying offers to sell and bids to purchase publicly registered limited partnership interest.

In addition to the broker-dealer requirements applicable to BDTs sponsors generally, these systems are monitored through conditions incorporated into such no-action letters, which are substantially similar to the requirements of Rule 17a-23. n8

n8 These conditions require system sponsors to submit periodic reports to the staff setting forth volume information, names of system participants and applicants denied participation, and affiliations between the sponsor and system participants. The letters also require sponsors to notify the staff prior to implementing material system changes.

The Commission previously has considered formalizing its oversight of automated trading systems. Most recently, the Commission proposed rule 15c2-10, which would have subjected sponsors to a number of procedural and substantive requirements. n9

n9 See Securities Exchange Act Release No. 26708 (April 13, 1989), 54 FR 15429. The Commission received comments from 32 commenters in response to the 1989 proposal of rule 15c2-10 and the Division's *Market 2000* concept release addressing regulation of PTSs. See Securities Exchange Act Release No. 30920 (July 14, 1992), 57 FR 32587 ("*Market 2000 concept release*") at 32594-32595. Sponsors of PTSs generally opposed the rule, while SROs generally supported the rule (except to the extent they questioned the authority of the Commission to regulate PTSs as broker-dealers or otherwise believed PTSs should be subject to the same regulation as SROs). A summary of comments that were made on the 1989 proposal and the *Market 2000 Study* has been prepared by the Commission's staff and is available in public reference file S7-3-94. See also *Market 2000: An Examination of Current Equity Market Developments*, Division of Market Regulation, SEC (January 1994) ("*Market 2000 Study*"), Appendix VI (Summary of Comments), pp. 32-38.

The Commission does not believe it is necessary at this time to adopt proposed rule 15c2-10. n10 At the same time, the Commission believes there is a need for enhanced recordkeeping and reporting by sponsors of BDTs, as described below.

n10 Some commenters to proposed rule 15c2-10 and the Division's *Market 2000 Study* have objected to the Commission's regulation of BDTs as broker-dealers. They have argued that certain BDTs compete for order flow with the exchanges and should be subject to exchange registration and regulation. See *Market 2000 Study*, Appendix VI (Summary of Comments), pp. 32-38. The Commission disagrees. There are many different competitors for order flow, e.g., derivative products, upstairs dealers, third market makers, and BDTs. These should not all be regulated identically simply because they compete for market share. The level of regulation should be tailored to the functions being performed by an entity and the corollary need for regulation. The functions performed by BDTs are most closely aligned with the functions performed by broker-dealers; consequently, broker-dealer regulation of BDTs sponsors is appropriate.

### **III. Need For Oversight of Broker-Dealer Trading Systems**

In adopting the Act, Congress recognized the need for oversight of the securities markets and participants, including requiring appropriate reports, to ensure the maintenance of fair

and honest markets and to protect the public interest. n11 The Rule will further these goals by enabling the Commission to evaluate the operation of BDTs with regard to national market system goals, to monitor the competitive effects of these systems, to ascertain whether broker-dealer regulation remains appropriate for the operation of such systems, and to identify areas where monitoring of such systems may be improved and where SRO surveillance may be more appropriately tailored to the detection of fraudulent, deceptive and manipulative practices in an automated environment.

n11 15 U.S.C. 78b.

Automation of securities trading provides significant benefits. n12 Computerization, however, has undeniably changed the operation of the securities industry, and the operation of BDTs appears to be a significant and growing part of such change. The Commission's efforts to gauge the impact of automation are hindered if critical information regarding the activity of automated systems is not recorded by system sponsors and regularly reported to the Commission in a useful form.

n12 Automation of securities trading reduces transaction costs, promotes competition, improves transparency of markets, increases opportunities for best execution and enlarges the opportunities for orders to be executed without the participation of a dealer. See Letter from Richard C. Breeden, Chairman, SEC, to Edward J. Markey, Chairman, Subcomm. on Telecommunications and Finance, Comm. on Energy and Commerce, U.S. House of Representatives, July 11, 1991, attaching memorandum to Chairman Breeden from the Division ("Breeden Letter"), at 11-15 (discussing how computerization of trading generally is consistent with national market system goals) reprinted in Market 2000 Concept Release, 57 FR 32587 (July 22, 1992). Technology is not infallible, however. Automated markets are vulnerable to myriad difficulties which could affect market operation and stability, including hardware failure, telecommunications interruptions, software failure and design flaws, and intrusion by unauthorized persons.

Because existing recordkeeping and reporting rules do not require broker-dealers to record BDTs volume and **[\*8370]** activity information separately from other brokerage activity or to report such information to the Commission on a regular basis, the Commission receives system-specific information only through conditions to no-action letters, as described above. The no-action letter process is an imperfect vehicle for these purposes: it provides the Commission with information on a limited number of BDTs, and does not provide sufficient clarity and guidance to enable prospective sponsors of BDTs to assess accurately their potential obligations under the Act. In order to review trading effected through an automated system that is not subject to a no-action letter, n13 or to analyze trading patterns in BDTs as a whole, the Commission or SROs currently would have to cull system-specific information from each sponsor's extensive brokerage activity records or rely on system sponsors to do so voluntarily each time the Commission needed such information, an inefficient and time-consuming task. n14

n13 In this release, the concept of transactions being "effected through" a trading system includes the matching, crossing or other negotiating of execution terms through the communication facilities of such a system. For these purposes, transactions can be considered "effected through" BDTs even if a transaction that is matched, crossed, or negotiated through system facilities ultimately is executed, compared, confirmed, cleared and/or settled through means other than the system.

n14 These concerns are minimized to some extent with regard to broker-dealers which operate solely as a BDTs.

*A. Market Structure and Competitive Concerns*

In the Securities Acts Amendments of 1975 ("1975 Amendments"), Congress clearly intended that the Commission actively evaluate its own regulations, the regulations of SROs, and the functioning of the securities market in general to further national market system goals and ensure that the public interest is protected as the national market system develops. n15 Although the Act recognizes that computerized trading generally has positive implications for the National Market System, n16 the Commission must thoroughly examine the implications of automated trading systems in order to fulfill its responsibilities under the 1975 Amendments. n17

n15 See, e.g., S. Rep. No. 75, 94th Cong., 1st Sess. (1975) ("Senate Report") at 12-14.

n16 See Section 11A(a)(1)(B) of the Act ("new data processing and communications techniques create the opportunity for more efficient and effective market operations"); Breeden Letter, 57 FR 32587 at 32601.

n17 Cf. Senate Report, at 9; Breeden Letter, 57 FR 32587, at 32601.

As the number, variety, complexity, and trading volume of BDTs continues to expand, these systems have the potential to significantly affect over-the-counter trading markets, n18 and trading patterns in listed securities. n19 Volume statistics and other information obtained from these systems would enable the Commission on an ongoing basis to assess the effects of these systems on the national market system structure. n20 Because market reporting mechanisms do not separately identify trades occurring through BDTs, n21 absent a review of each system sponsor's records the Commission obtains incomplete information about industry-wide BDTs volume and trading activity, making it difficult to measure accurately the effect of these systems on market transparency, competition, and the distribution of trading activity among different markets.

n18 For example, trade volume on PTSs has steadily increased since 1989. The total share volume on PTSs was almost the same in the first half of 1993 (4.7 billion) as for the entire 1992 year (4.9 billion), which was itself an increase of more than 60% over the previous year's volume of 2.9 billion. Almost 87% of the PTS volume in the first half of 1993 was in NASDAQ stocks, 13% was in listed stocks. Although still relatively low, the rising trend in PTS volume is consistent with the increasing volume occurring in the equity markets as a whole. During the first half of 1993, PTSs captured 1.4% of the volume in NYSE stocks and 13% of the volume in NASDAQ/NMS stocks. Market 2000 Study, Study II (Structure of U.S. Equity Markets), p. 13.

n19 For example, third market makers handled 7.4% of reported NYSE volume in 1993 and 9.3% of the reported trades. Market 2000 Study, Study II (Structure of U.S. Equity Markets), p. 11. Under current reporting requirements, the Commission cannot readily identify how much of third market volume is attributable to transactions effected through BDTs.

n20 In particular, Rule 17a-23 can provide the Commission with information not currently available about technological developments and market structure changes that could affect national market systems. For example, no current recordkeeping or reporting requirement provides a means for assessing the potential impact of redirecting order flow from trading systems operated by SROs, which are fully integrated into the national market system, to BDTs.

n21 Trades occurring through BDTs are subject to the same reporting requirements as other trades executed by registered broker-dealers, and therefore are generally reported to consolidated reporting systems during normal trading hours and to SROs for regulatory purposes after normal trading hours. These reported trades, however, are not identified as occurring through BDTs, making it difficult to obtain accurate trading volume data for BDTs which are not otherwise providing data to the Commission.

Not only may a significant amount of trading in national market system securities occur through BDTs, it is probable that sponsors will continue to create BDTs to facilitate transactions in products not trading in organized markets, including various derivative products. Standardized reporting requirements would assist the Commission in monitoring the interaction between activity in these markets and activity in underlying markets. In addition, some of these "niche" systems may provide the only readily identifiable source of trading opportunity in a particular over-the-counter instrument. n22 A reporting mechanism such as Rule 17a-23 would help alleviate the difficulty of obtaining accurate information on a regular basis about cumulative trading in these instruments.

n22 The Division has issued no-action letters to four automated trading systems which provide a trading facility for securities otherwise trading in a dispersed manner: RMJ-Delta (Treasury options); CrossCom (high-yield debt); and NAPEX and Cantor Fitzgerald's system (limited partnership interests).

*B. Adequacy of Broker-dealer Regulation and the Detection of Fraudulent or Manipulative Activity*

The information required by the Rule is necessary to understand the implications of the ongoing integration of BDTs into existing market structures and to evaluate the appropriateness of current regulations and oversight as applied to non-traditional market participants, n23 such as automated third market makers. In its Market 2000 Study, the Division recommended trading principles to which third market makers should adhere and the development by SROs of examination modules tailored to third market makers. n24 Recordkeeping and reporting that specifically identifies trading activity in BDTs operated by third market makers is a crucial element in enhancing current oversight programs of these automated dealers. Comprehensive examination of these market makers would be enhanced by the ready availability of information about execution algorithms, transaction records, and activity summaries. Without such information, it is difficult for the SROs to evaluate and monitor the trading activity of automated third-market makers and other BDTs [\*8371] accurately. n25 This difficulty inhibits the ability of the SROs and the Commission to ensure

that broker-dealer regulation keeps pace with the changing attributes of technologically advanced broker-dealers.

n23 The fact that BDTs do not conform to traditional conceptions of broker-dealer activity does not, by itself, mean that such systems are securities "exchanges." The Commission has interpreted the definition of "exchange" primarily to encompass those entities that have been designed, whether through trading rules, operational procedures, or business incentives, to centralize trading and provide buy and sell quotations on a regular or continuous basis so that purchasers or sellers have a reasonable expectation that they can regularly execute their orders at those price quotations. For a discussion of factors relevant to applicability of exchange definition, see Securities Exchange Act Release No. 27611 (January 12, 1990), 55 FR 1890; *Board of Trade of the City of Chicago v. SEC*, 923 F.2d 1270 (7th Cir. 1991), rehearing en banc denied, No. 90-1246 (7th Cir. 1991); and *In re Wunsch Auction Systems, Inc.*, Securities Exchange Act Release No. 28899 (February 20, 1991), 56 FR 8377.

n24 Market 2000 Study, Main Report, pp. 25-26.

n25 For example, understanding the execution algorithms of a BDTs is necessary to evaluate whether the automated execution provided by the system complies with SRO fair practice rules. The Rule would require a BDTs sponsor to provide the Commission with information describing the system's operation and execution procedures, so that the Commission may evaluate the system's volume and activity information accurately.

The lack of routinely reported, system-specific information in a useful format also hampers the Commission's ability to identify areas where SRO surveillance may be more appropriately tailored to the detection of fraudulent, deceptive and manipulative practices in an automated environment. Although sponsors of BDTs are regulated as broker-dealers, automation of their activities has enabled these entities to collect, disseminate, and process trading interest and activity in a manner that is not customary of (and often not possible with) traditional non-automated broker-dealer trading techniques. This has the potential to expose these non-traditional broker-dealer systems to manipulative practices typically associated with markets, not with traditional broker-dealers. The availability of system-specific trading information to appropriate SROs will provide better tools to detect potential trading abuses. n26

n26 The Commission recognizes that there are significant economic incentives for BDTs to provide reliable and fair facilities for experienced market participants to effect transactions. Economic incentives, however, will not always provide sufficient motivation to prevent fraudulent practices. See Oversight Hearings on the Future of the Stock Market Focusing on Proprietary Trading Systems Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 1st Sess. (May 26, 1993).

The Rule also would enable the Commission to identify ways in which securities law violations can occur in an automated environment. For example, the availability of automated means for a broker-dealer to broadcast interest in securities, to groups whose composition is not determined by the broker-dealer, may make it more difficult for the broker-dealer to satisfy the conditions of Rule 144A under the Securities Act. n27 The Rule would provide the Commission with information necessary to its evaluation of the effectiveness and enforceability of the securities laws in an automated trading environment, which is currently

not readily available.

n27 In this context, sponsors should consider that requirements of the Securities Act may make it inappropriate for broker-dealers to trade certain restricted or unregistered securities on BDTs unless the system is configured to accommodate Securities Act regulations governing trading of such securities.

#### **IV. Description of the Rule**

The proposed Rule would require a registered broker-dealer who acts as the sponsor of a "broker-dealer trading system" to make and keep current specified records, and file reports with the Commission and the appropriate SRO on proposed Form 17A-23. The records that system sponsors would be required to keep under the Rule consist of: (1) daily summaries of trading in the system and time-sequenced records of trades; (2) information regarding system participants and applicants who have been refused participation in the system; and (3) notices sent by the sponsor to participants. n28 The reports that system sponsors would be required to file under the Rule consist of: (1) An initial description of the system, including its organization, operation, automated facilities, and date of commencement of operation; (2) quarterly summaries of activity in the system; and (3) notification, when appropriate, of material changes to the system and its cessation of operations. n29

n28 The Rule would not require sponsors of BDTs to duplicate trading records maintained in the course of its normal recordkeeping operations; however, the Rule would require that sponsors develop and maintain the ability to sort and retrieve system records separately.

n29 The Rule does not dictate a format for submitting the required information. This will enable a BDTs sponsor to comply with this requirement without significant adjustment to its own internal volume monitoring systems.

##### *A. Scope*

###### **1. Application to Registered Broker-Dealers**

Rule 17a-23 applies to any "registered broker or dealer" that acts as the sponsor of a trading system. "Registered broker or dealer" is defined in Section 3(a)(48) of the Act to include any broker or dealer registered or required to register pursuant to section 15(b) (the majority of broker-dealers) or 15B (municipal securities broker-dealers) of the Act. n30 As noted earlier, absent an exemption from or exception to the broker-dealer registration provisions of the Act, the types of activities conducted by BDTs can be lawfully conducted only by a broker-dealer registered with the Commission pursuant to the Act.

n30 The Rule would not apply to government securities brokers or government securities dealers registered under Section 15C of the Act, which are required to comply with the recordkeeping and reporting requirements of regulations promulgated by the Department of the Treasury under the Government Securities Act of 1986, 17 CFR 400 et seq. In addition, the Rule would not apply to operators of systems that do not involve activities requiring broker-dealer registration, such as "bulletin board" systems displaying quotations and orders, and identifying telephone numbers or other information to allow participants to contact an

entity displaying quotations or orders without further intercession and without receipt of transaction-based compensation by the system operator. See Letters regarding Farmland Industries, Inc. (Aug. 26, 1991); Troy Capital Services, Inc. (May 1, 1990); Real Estate Financing Partnership (May 1, 1990); Ivestex Investment Exchange, Inc. (April 9, 1990); and Petroleum Information Corporation (Nov. 28, 1989). *Cf.* Securities Exchange Act Release No. 27017 (July 11, 1989), 54 FR 30013, text accompanying n. 66.

## 2. Sponsor

The Rule defines a sponsor as "any entity that organizes, operates, administers, or otherwise directly controls a broker-dealer trading system." In addition, the Rule includes within this term any registered broker-dealer that regularly executes or processes transactions on behalf of participants of a system operated by a non-registered entity. This provision is designed to prevent the operator of a BDTs from avoiding applicability of the Rule to its system by avoiding registration as a broker-dealer. Some entities that operate BDTs may attempt to do this by "contracting out" responsibility for executing system transactions to another entity (which generally would not be considered to operate, administer or control the system). n31 In such circumstances Rule 17a-23 would apply to the registered broker-dealer executing transactions on behalf of the system sponsor. Although the Commission recognizes the need to allow for flexibility in a trading system's operational structure, improved oversight of BDTs can be achieved only if automated trading systems provide uniform and consistent information to the Commission and the SROs on a regular basis, regardless of organizational structure.

n31 Such an arrangement may be permissible in certain circumstances, however the Division will evaluate such arrangements based on the facts and circumstances of each case.

## 3. Broker-dealer Trading System

The term "broker-dealer trading system" is defined as "(i) any system that automatically executes orders to buy or sell securities against quotations of the system sponsor or its affiliates \* \* \* or (ii) any system that *both* automates the dissemination or collection of quotations, orders to buy or sell securities, or indications by any person announcing a general interest in buying or selling a security, submitted by entities other than the system sponsor and its affiliates, *and* provides a mechanism for matching or crossing [**\*8372**] orders in the system, or for otherwise facilitating agreement between participants to the basic terms of a purchase or sale of a security through use of the system." (Emphasis added.)

This definition is intentionally broad. Part (i) of the definition would include systems that provide automated access to, and execution against, proprietary two-sided quotations of market makers. This would make the Rule applicable to large, integrated dealers in NASDAQ and exchange-listed securities that offer automated execution of the market orders of other brokers and dealers at the best consolidated bid and ask price. n32

n32 Some of these systems also offer the possibility of price improvement for orders in securities whose bid/ask spread exceeds defined parameters and limit order protection for priced orders that are "away" from the inside market.

Part (ii) of the definition would only apply to systems that *both* automate the collection or dissemination of orders, interest, or quotations, and provide a mechanism for matching, crossing, or otherwise facilitating execution of orders through the system. In order for a

system to fall within this part of the definition, it must provide a mechanism for facilitating participant agreement to the terms of a transaction through use of the system. n33 Broker-dealer operated systems that automate the collection of orders, but do not provide a mechanism for matching, crossing, or facilitating participant agreement to terms of a transaction through use of the system would not be included in this definition. n34 The definition would include systems that automate the collection of orders and match those orders against other participant trading interest, regardless of whether or not those orders are disseminated to system participants prior to matching. n35

n33 The term "use of the system" includes contacting the sponsor of a system to finalize a transaction based on trading interest displayed in the system, whether such contact is telephonic or automated. See note 34, *infra*.

n34 Several broker-dealers operate "bulletin board" systems on which participants display indications of interest or orders and provide telephone numbers or other identifying information. Other system users may then utilize this information to contact that participant directly and execute a transaction without intercession by the system or the system operator. Such an arrangement does not allow participants to agree to the terms of a transaction "through use of the system"; participants must contact each other outside of system facilities or the system sponsor to conclude a transaction. Therefore, the Rule would not apply to these systems. In contrast, the Rule would apply to broker-dealer operated systems that automate the collection of orders, and display those orders to participants, but require a participant to contact the system sponsor telephonically or otherwise (rather than another participant) in order to finalize a transaction through the system.

n35 If a match of trading interest occurs in listed securities subject to off-exchange trading restrictions, the system would generally send those matched orders to an exchange or other market center to be "printed" as an "agency cross."

#### 4. Exclusions

A number of broker-dealer automated systems have been expressly excluded from the definition of "broker-dealer trading systems" to clarify application of the Rule. The Commission recognizes that many broker-dealers have automated their internal operations without significantly changing the nature of traditional broker-dealer operations. For this reason, the Rule would not apply to a system that merely automates the collection and routing of orders to the sponsor's trading desk, through automation of the sponsor's order entry, order collection or internal order-routing functions. Nor would it apply to a system that merely routes customer orders to the execution facilities of another dealer, a registered national securities exchange, or a trading system operated by a person other than the routing system operator. n36 These exclusions are premised on the Commission's view that these routing systems do not require the same degree of Commission oversight and SRO surveillance as systems that have automated mechanisms for facilitating securities transactions outside of traditional organized markets or traditional over-the-counter brokerage activities. Because routing systems direct orders to organized markets such as exchanges, these systems are integrally tied into existing market oversight structures and do not pose the same concerns regarding potential effects on the national market system.

n36 This exclusion would only apply to systems that route customer orders to other execution centers without any intervening matching or crossing by the system. Systems which match or cross orders internally and then route the matched orders to an exchange or other execution center for execution as an "agency cross" would not be excluded from application of the Rule under this exclusion. See note 35.

The Commission solicits comment on whether the Rule should also exclude interdealer brokers that facilitate trading of municipal or government securities. n37

n37 As proposed, the Rule would apply to interdealer brokers facilitating trading in municipal or government securities registered under Sections 15 or 15B. The Rule would not apply to interdealer brokers registered under Section 15C. See note 30.

### *B. Requirements of the Rule*

#### 1. Recordkeeping

Under the Rule, system sponsors would be required to keep and make available to the Commission and the appropriate SRO, upon request, records of: (1) daily summaries of trading in the system (including number of transactions, transaction volume, securities traded, and number of quotations and orders placed by participants); (2) the identities of system participants (including any affiliations between those participants and the sponsor) and applicants who have been refused participation in the system; and (3) time-sequenced records of each transaction effected through the system. The sponsor would be required to keep these records, as well as any notices provided by the sponsor to participants, for three years (the first two years in an easily accessible place).

Sponsors of BDTs already may be maintaining some or all of the transaction information pursuant to the requirements of Rules 17a-3 or 17a-4 under the Act. The Rule does not require a sponsor to keep duplicate records in such circumstances, if the sponsor's recordkeeping system can sort and retrieve the information required under the Rule from its other records promptly upon request.

#### 2. Reporting

Sponsors also would be required to file confidential reports with the Commission (with duplicate originals filed simultaneously with the appropriate SRO) in accordance with proposed Form 17A-23. This Form would contain three parts: (1) an initial report filed at least 20 calendar days prior to the operation of the system; (2) quarterly reports filed within 20 calendar days after the end of the calendar quarter; and (3) a final report filed within 10 calendar days after a sponsor ceases to operate the trading system. The pre-operational report would describe the system, its procedures for reviewing capacity, security and contingency planning, and protecting participant funds and securities (if an entity other than the sponsor will hold or safeguard participant funds or securities on a regular basis). It also would identify an appropriate system contact. The quarterly reports would contain volume information, notification of the intent to offer (or the current availability of) services to U.S. customers that would allow them to trade with entities outside the U.S. otherwise than through a registered broker or dealer, n38 and notification of material system changes. The report notifying the Commission of cessation of operations would contain, [\*8373] in addition to the notification, a final transaction summary.

n38 See Securities Exchange Act Release No. 27017 (July 13, 1989), 54 FR 30013 (foreign

broker-dealers whose quotes are distributed through third-party systems may not initiate contacts with U.S. persons without registering as broker-dealers under § 15 of the Act, except as allowed by Rule 15a-6).

### 3. Record Maintenance

Records may be produced, reproduced, and maintained pursuant to the provisions of Rule 17a-4(f) under the Act. n39 Although record maintenance under the Rule is the sole responsibility of the sponsor, records required to be maintained and preserved under the Rule may be prepared or maintained by a service bureau, depository or other recordkeeping service on behalf of the sponsor, provided such entity complies with Rule 17a-4(i) under the Act.

n39 Rule 17a-4(f) provides for the maintenance of records on microfilm. The Commission recognizes that BDTs sponsors generally will wish to maintain records in electronic formats. The Commission has proposed and published for comment an amendment to Rule 17a-4 which would provide for optical disk storage if certain protective safeguards are employed to preserve the data. See Securities Exchange Act Release No. 32609 (July 9, 1993), 58 FR 38092. See also Letter to Michael D. Udoff, Chairman, Ad Hoc Record Retention Committee, Securities Industry Association, Re: Optical Storage Technology (June 18, 1993).

### 4. Exemptions

The Commission could exempt any system sponsor from any or all of these requirements, if the Commission determines that such exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and perfection of the mechanisms of, a national market system for securities and a national system for the clearance and settlement of securities transactions.

#### *C. Effect of the Rule on Existing No-Action Letters* n40

The Commission recognizes that BDTs sponsors subject to no-action letters already may comply with many of the reporting requirements of the Rule pursuant to conditions of such letters. The Commission anticipates that the Rule would become effective six months after adoption. Sponsors of BDTs subject to reporting requirements pursuant to no-action letters or other Commission orders may contact the Division to discuss the continuing applicability of such conditions if the Rule is adopted.

n40 The Rule does not address the issue of whether a particular trading system may be required to register as a national securities exchange, clearing agency, or other SRO. Sponsors of BDTs seeking relief from exchange, clearing agency, and other SRO registration requirements may continue to request no-action positions from the Division.

## **V. Request for Comments**

The Commission requests comment on the issues raised in the release, including without limitation the consistency of the Rule's approach with the policies underlying the Act, and the scope of terms defined in the proposed Rule, including "broker-dealer trading system" and "sponsor." Commenters are encouraged to focus on the following matters:

(1) The number of entities that would be required to comply with the Rule as proposed;

(2) Whether the Rule should apply to systems excluded in the proposed Rule from the definition of broker-dealer trading systems and, if so, why;

(3) Whether the Rule should apply to bulletin board information systems, or whether the Commission should separately adopt a rule for bulletin board systems pursuant to its authority under section 11A(b)(1) of the Act n41 relating to securities information processors, and what the content of any such rule should include; and

n41 15 U.S.C. 78k-1(b)(1).

(4) Whether government or municipal securities brokers, dealers, or interdealer brokers registered under section 15 or 15B of the Act should be excluded from application of the Rule and, if so, why;

(5) The interval at which sponsors should file reports required by the Rule (i.e., quarterly, semi-annually, etc.);

(6) whether the Rule should require a sponsor to provide the Commission with direct, on-line access to its system upon request; and

(7) the costs and benefits of the proposed Rule, especially whether the Rule's requirements are duplicative or burdensome.

With regard to this last issue, based upon the Commission's experience, the anticipated costs to sponsors of existing BDTs and the developers of new BDTs if the Commission adopts the Rule do not appear to be significant or to unduly impede the development or viability of new systems. The complete automation of trading which characterizes BDTs is particularly well suited for maintaining comprehensive and accurate records. Many BDTs sponsors already maintain records and provide information to the Commission pursuant to no-action letters which are substantially similar to the requirements of the Rule. Some BDTs sponsors that are not subject to conditions of a no-action letter nonetheless currently maintain many of the records required by Rule 17a-23. Thus, compliance with the Rule would appear to require little adjustment to their current recordkeeping. Similarly, for BDTs sponsors that have automated all of their trading operations, the Rule would appear to entail few operational changes or additional costs.

## **VI. Competition Findings**

Section 23(a)(2) of the Act n42 requires the Commission, in adopting rules under the Act, to consider the anti-competitive effects, if any, of such rules and to balance any impact against the regulatory benefits gained in terms of furthering the purposes of the Act. The Commission has considered the proposed Rule in light of the standard cited in Section 23(a)(2) and preliminarily believes that adoption of the proposed Rule will not impose any burden on competition not necessary or appropriate in furtherance of the Act.

n42 15 U.S.C. 78w(a)(2).

## **VII. Summary of the Initial Regulatory Flexibility Analysis**

The Commission has prepared an Initial Regulatory flexibility Analysis ("IRFA") in accordance with 5 U.S.C. sec. 603 regarding the proposed Rule. The following summarizes the conclusions of the IRFA.

The IRFA uses certain definitions of "small entities" adopted by the Commission for purposes of the Regulatory Flexibility Act. The IRFA states that the Commission currently has no uniform reporting mechanism regarding the number of broker-dealers that operate automated trading systems as defined by the proposed Rule, and the Commission is, therefore, unable to reasonably estimate the number of small entities that would be required to comply with the Rule. The Division's experience with PTSs has indicated that the implementation of automated trading systems requires large capital expenditures. Therefore, the Commission believes BDTs that operate pursuant to the proposed Rule will be sponsored, with few exceptions, by larger, well-capitalized broker-dealer firms.

The IRFA states that the proposed Rule would allow the Commission to confirm that investors effecting trades through BDTs are adequately protected, the systems do not impede the maintenance of fair and orderly markets, or otherwise operate in a manner that is inconsistent with the federal securities laws. The IRFA sets forth the concerns with the current regulatory approach, and discusses possible alternatives to the proposed Rule for the regulation of small entities. Finally, the IRFA solicits comments on any possible costs the proposed Rule might have on small entities, and on possible alternatives with regard to small entities.

A copy of the IRFA may be obtained from Sarrita J. Cypress, Office of [\*8374] Automation and International Markets, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549, 202/272-2827.

### **VIII. Statutory Basis**

Pursuant to the Securities Exchange Act of 1934 and particularly Sections 2, 3, 11A, 15(c), 17, and 23(a) thereof, 15 U.S.C. 78b, 78c, 78k-1, 78o(c), 78q, and 78w(a), the Commission proposes to add § 240.17a-23 in chapter II of title 17 of the Code of Federal Regulations.

#### **List of Subjects in 17 CFR Parts 240 and 249**

Reporting and recordkeeping requirements, Securities.

#### **Text of Proposed Rule 17a-23**

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

#### **PART 240-GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

1. The authority citation for Part 240 is amended by adding the following citation:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78i, 78j, 78l, 78m, 78n, 78o, 78p, 78s, 78w, 78x, 78l(d), 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4 and 80b-11, unless otherwise noted.

\* \* \* \* \*

Section 240.17a-23 also issued under 15 U.S.C. 78b, 78c, 78o, 78q, and 78w(a);

\* \* \* \* \*

2. Section 240.17a-23 is added to read as follows:

**§ 240.17a-23 -- Recordkeeping and reporting requirements relating to broker-dealer trading systems.**

(a) *Scope of section.* This section shall apply to any registered broker or dealer that acts as the sponsor of a broker-dealer trading system.

(b) *Definitions.* For purposes of this section:

(1) The term *registered broker or dealer* shall have the meaning ascribed to it in Section 3(a)(48) of the Act.

(2) The term *broker-dealer trading system* means:

(i) Any system that automates the execution of orders to buy or sell securities based on quotations of the system sponsor or its affiliates (whether such quotations are disseminated through the system, a quotation consolidation system operated pursuant to a plan approved by the Commission under Section 11A of the Act, an electronic interdealer quotation system operated by a registered national securities association, or otherwise); or

(ii) Any system that both automates the dissemination or collection of quotations, orders to buy or sell securities, or indications by any person announcing a general interest in buying or selling a security, submitted by entities other than the system sponsor and its affiliates, and provides a mechanism for matching or crossing, or for otherwise facilitating agreement between participants to the basic terms of a purchase or sale of a security through use of the system. "Broker-dealer trading system" does not include:

(A) A system that automates the collection and routing of orders to a broker or dealer's trading desk or individual trading personnel, through automation of the broker or dealer's order entry, order collection or internal order-routing functions, where the system does not provide automated matching, crossing, or execution of orders in the system based on preset or programmed parameters without intervention by individual trading personnel; or

(B) An automated system that routes customer orders to the execution facilities of a dealer other than the operator of such routing system, of a registered national securities exchange, or of a broker-dealer trading system operated by a person other than the operator of such routing system, where the operator of the routing system does not provide a mechanism for matching, crossing, or executing orders in the system against other orders in the system, or for otherwise allowing agreement to the basic terms of a transaction in a security through use of the system, apart from the execution facilities of those other entities.

(3) The term *sponsor* means any entity that organizes, operates, administers, or otherwise directly controls a broker-dealer trading system; and any registered broker or dealer that, pursuant to contract, affiliation, or other agreement with the system operator, is involved materially on a regular basis with effecting or processing transactions executed in connection with use of the system, other than for its own account or as a participant in the system, if the sponsor of such broker-dealer trading system is not a broker or dealer registered pursuant to Section 15 of the Act.

(c) *Recordkeeping.* Every registered broker or dealer subject to this section pursuant to paragraph (a) of this section shall:

(1) Make and keep current the following records relating to the broker-dealer trading system:

(i) A record of participants in the system (identifying any affiliations between system

participants and the system sponsor) and applicants who have been refused participation in the system;

(ii) Daily summaries of trading in the system, including:

(A) Securities trading in the system;

(B) Transaction volume (separately stated for trading occurring during hours when consolidated trade reporting facilities are not in operation), expressed in trades, shares and in dollar value with respect to stock, and for other securities, expressed in trades, number of units of securities, par value, dollar value, or any other commonly used measure of amounts of securities; and

(C) Number of quotations and orders placed in the system by persons other than the sponsor and its affiliates, if applicable (expressed separately for limit and market orders and for any other relevant order specification required or allowed by the system other than price and size);

(iii) Time-sequenced records of each transaction effected through the broker-dealer trading system, including date and time executed, price, size, security traded, counterparty identification information, and method of execution (if broker-dealer trading system allows alternative means or locations for execution, such as routing to another market, matching with limit orders, or executing against the system sponsor's quotations); and

(2) Preserve, for a period of not less than three years, the first two years in an easily accessible place, the following records relating to the broker-dealer trading system:

(i) All records required to be made pursuant to paragraph (a)(1) of this section; and

(ii) Any notices provided by the system sponsor to system participants, including, but not limited to, notices addressing hours of system operations, system malfunctions, changes to system procedures, maintenance of hardware and software, instructions pertaining to access to the system, and notices of denials or limitations of access to the system.

(d) *Reporting.* (1) Every registered broker or dealer subject to this section pursuant to paragraph (a) of this section shall:

(i) At least 20 calendar days prior to operating a broker-dealer trading system, file Part I of Form 17A-23 (§ 249.636 of this chapter); **[\*8375]**

(ii) During the operation of a broker-dealer trading system of which the broker or dealer is the sponsor, file the information described in Part II of Form 17A-23 (§ 249.636 of this chapter) within 20 calendar days after the end of the calendar quarter; and

(iii) Within 10 calendar days after a broker-dealer trading system of which the broker or dealer is the sponsor ceases to operate, file the notice described in Part III of Form 17A-23 (§ 249.636 of this chapter).

(2) The reports provided for in this paragraph (d) shall be considered filed upon receipt at the Commission's principal office in Washington, DC. Duplicate originals of such reports must be filed with the self-regulatory organization designated as the examining authority for the broker or dealer pursuant to § 240.17d-1 simultaneously with filing with the Commission. All reports filed pursuant to this paragraph (d) shall be deemed to be confidential.

(e) *Maintenance of records in alternative form.* The records required to be maintained and preserved pursuant to this section may be produced, reproduced and maintained pursuant to

the provisions of § 240.17a-4(f).

(f) *Compliance with other recordkeeping and reporting rules.* Nothing in this section obviates the need for any broker or dealer to comply with any other applicable recordkeeping or reporting requirement under the Act and the rules and regulations thereunder. If the information in a record required to be made pursuant to this section is preserved in a record made pursuant to § 240.17a-3 or § 240.17a-4, paragraph (c) of this section shall not require the sponsor to maintain such information in a separate file, if the sponsor can promptly sort and retrieve the information as if it had been kept in a separate file as a record made pursuant to this section.

(g) *Maintenance of records by others.* The records required to be maintained and preserved pursuant to this section may be prepared or maintained by a service bureau, depository or other recordkeeping service on behalf of the sponsor of a broker-dealer trading system, provided such entity complies with the provisions of § 240.17a-4(i). Agreement with such an entity shall not relieve the sponsor of a broker-dealer trading system from the responsibility to prepare and maintain records as specified in this section.

(h) *Furnishing copies of records.* Every broker or dealer subject to this section pursuant to paragraph (a) of this section shall furnish to any representative of the Commission and of the self-regulatory organization designated as its examining authority pursuant to § 240.17d-1, promptly upon request, legible, true and complete copies of those records of the sponsor that are required to be preserved under this section.

(i) *Exemption from this section.* The Commission, by rule or order, may exempt any sponsor of a broker-dealer trading system from all or any of the provisions of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and perfection of the mechanisms of, a national market system for securities and a national system for the clearance and settlement of securities transactions.

(j) *Effective date.* The effective date of this section shall be [six months after date of adoption of final rule].

#### **PART 249-FORMS, SECURITIES EXCHANGE ACT OF 1934**

3. The authority citation for part 249 continues to read in part as follows:

**Authority:** 15 U.S.C. 78a, *et seq.*, unless otherwise noted;

\* \* \* \* \*

4. Section 249.636 and Form 17A-23 are added to read as follows:

**Note:** The text of proposed form 17A-23 appears in Appendix A to this document and will not appear in the Code of Federal Regulations.

#### **§ 249.636 -- Form 17A-23, information required of certain brokers and dealer sponsors of trading systems pursuant to section 17 of the Securities Exchange Act of 1934 and § 240.17a-23 of this chapter.**

This form shall be used by every registered broker and dealer that is required to file reports under § 240.17a-23 of this chapter.

Dated: February 9, 1994.

By the Commission.

**Margaret H. McFarland,**

*Deputy Secretary.*

**[\*8376]**

Official Use Only  
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APPENDIX A

OMB Approval  
OMB No.:  
Expires

U.S. SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 17A - 23

Information Required of Registered Broker or Dealer Sponsor  
of Broker-Dealer Trading System Pursuant to Section 17 of  
the Securities Exchange Act of 1934 and Rule 17a-23 Thereunder

READ ALL INSTRUCTIONS PRIOR TO COMPLETING THE FORM

Indicate in this Report is: Initial Report (Part I)  
FORM 17A-23 --- Quarterly Report (Part II) --- Final Report  
Page 1 (Part III) ---

If Quarterly or Final Report state period covered by  
Report ----- through -----  
mm/dd/yy mm/dd/yy

-----  
SPONSOR INFORMATION  
-----

NAME OF BROKER-DEALER TRADING SYSTEM  
-----

NAME OF REGISTERED BROKER OR FIRM CRD NO -----  
DEALER SPONSOR OF SYSTEM  
-----

NAME OF SYSTEM OPERATOR  
(If different from Registered Broker or Dealer Sponsor of System)  
-----

(No and Street)

-----  
(City) (State) (Zip code)  
-----

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT WITH REGARD TO  
THIS REPORT

-----  
-----  
EXECUTION  
-----

The registered broker or dealer sponsor submitting this form and the executing official hereby represent that all the information contained here is true, correct and complete.

-----  
Manual signature of Official    Title  
responsible for form  
-----

Name of Office responsible for    Data executed (Month/Day/Year)

-----  
38  
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**[\*8377]**

FORM 17A-23 READ ALL INSTRUCTIONS PRIOR TO COMPLETING FORM  
Page 2  
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PART I: INITIAL OPERATION REPORT  
(To be filed at least 20 calendar days prior to operation)  
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Provide the following information

1. State the securities or types of securities eligible for trading on or through the facilities of the system.
2. State the name and address of any entity that will be involved in the operation of the system, or will execute, clear or state transactions on behalf of the sponsor or system participants in connection with operation of the system (other than system sponsor). Briefly describe the nature of such involvement and the responsibilities of such entity with respect to operation of the system and/or execution, clearance or settlement of transactions in connection with operation of the system.
3. Briefly describe the manner of operation of the system, including the procedures governing entry of quotations and orders into the system, access to the system; execution, reporting, clearance and settlement of transactions in connection with the system; and procedures for ensuring participant compliance with system usage guidelines. Attach copy of system user's manual, if available.
4. Briefly describe the sponsor's procedures for reviewing system capacity and security and contingency planning procedures.
5. If any entity other than the sponsor will hold or safeguard participant funds or securities on a regular basis, briefly describe the controls that will be implemented to ensure the safety of those funds and securities.

6. State the date the sponsor (or system operator, if other than sponsor) will begin operating the system.

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PART II: QUARTERLY REPORT

(To be filed at least 20 calendar days prior to operation)

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Provide the following information:

1. Total volume and average daily volume of transactions effected through the system during the period covered by the report and year-to-date aggregates of these numbers, expressed in (a) number of shares; (b) number of transactions; and (c) money value. Provide separate share transactions, and monetary volume and average daily volume information for the period covered by the report reflecting (a) system activity in securities listed on a registered national securities exchange; (b) system activity in securities quoted on the National Association of Securities Dealers' Automated Quotation service; (c) system activity occurring during regular trading hours of the New York Stock Exchange and (d) system activity occurring outside regular trading hours of the New York Stock Exchange and (d) system activity occurring outside regular trading hours of the New York Stock Exchange.
2. List of securities trading in the system during the period covered by this report.
3. Total number of quotations and orders placed in the system by persons other than the sponsors, system operator (if other than the sponsor), and their affiliates during the period covered by this report, if applicable, and year-to-date aggregates of the number. Express separately for limit and market orders and for any other relevant order specification required or allowed by the System other than price and size.
4. State if sponsor (or system operator, if other than sponsor) intends to offer, or has offered, service that allow system participants located within the jurisdiction of the United States to enter into securities transactions with entities outside of the jurisdiction of the United States, other than through a registered broker or dealer.
5. Describe any material changes to the information previously filed by sponsor with the Commission pursuant to Part of this Form.

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PART III: REPORT OF CEASING TO OPERATE OR SPONSOR SYSTEM

(To be filed within 10 calendar days after sponsor ceases to operate or sponsor System)

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Provide the following information:

1. State the date the sponsor ceased to operate or sponsor the System. State whether another entity will continue to operate or sponsor the System and provide the name, address, and telephone number of such entity, if available.
2. Provide information requested in item 1-3 of Part II for the period beginning on the day after the period covered by the most recent Form 17A-23 Part II filing and ending on the date stated in item 1 of this Part (date sponsor ceased to operate or sponsor the System).

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**[\*8378]**

U.S. SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

INSTRUCTIONS FOR COMPLETING FORM 17A - 23

I. Terms

Unless the context clearly indicate otherwise, terms used in this Form have the meaning ascribed to them in the Securities Exchange Act of 1934 and Rule 17a-23 thereunder.

II. Who must file; Where to file

Rule 17a-23 requires that every registered broker or dealer that acts as the sponsor of a broker-dealer trading system file Part I of Form 17A-23 at least 20 calendar days prior to operating or sponsoring a broker-dealer trading system, file Part II of Form 17A-23 within 20 calendar days after the end of each calendar quarter during which the sponsor operator or sponsors a broker-dealer trading system, and file Part III of Form 17A-23 within 10 calendar days after the sponsor ceases to operate or sponsor a broker-dealer trading system.

III. Number of copies: How and where to file

File the original and one copy of each Form 17A-23 filing with the SEC at Office of Automation and International Market, Division of Market Regulation, 450 5th street, N.W., Washington D.C. 20549, and one duplicate copy with the self-regulatory organization designated as the examining authority for the sponsor pursuant to Rule 17d-1 simultaneously with the filing of the original with the SEC. The sponsor must keep an exact copy of the filing for its records. All copies must be eligible. The filing date of any Form 17A-23 filing is the date of its actual receipt by the SEC, provided that the filing complies with the applicable requirements.

IV. Format of Filing

A sponsor may use the printed Form 17A-23 or a reproduction of

it. In either case, complete page 1 of Form 17A-23 in the format provided Number each page following page 1 consecutively, and give the name of the broker-dealer trading system and the date at the top of each page, and identify the Part to which the information on that page relates.

#### V. Completing Form

If the sponsor of a broker-dealer trading system has not previously filed a Form 17A-23 with respect to the system, complete page 1 and Part I. If the sponsor has previously completed Part I in a Form 17A-23 filed with respect to the system, and continues to operate or sponsor the system, complete page 1 and Part II only. If the sponsor has ceased to operate or sponsor the system, complete page 1 and Part III only. Provide information required by each Part of the Form by typing and printing the text of each item followed by the response thereto. Numerical information required by Parts II and III (item 2) may be provided in chart form. Print or type all numbers and responses.

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[FR Doc. 94-3703 Filed 2-17-94; 8:45 am]

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