



Securities Industry Association  
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July 26, 2005

Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-9303

Re: SR-NASD-00-23; Amendment No. 2 to Order Audit Trail System Rules

Dear Mr. Katz:

The Securities Industry Association (“SIA”)<sup>1</sup> appreciates the opportunity to comment on the NASD’s rule filing and amendments thereto proposing to implement Phase 3 of the Order Audit Trail System (“OATS”). As amended, the proposed rule change would require members to capture and report, for manual as well as electronic orders, both the time an order is received by the member from a customer and the time the order is received by the member’s trading desk or trading department, if those times are different. The proposed rule change also would exclude certain members from the definition of “Reporting Member” for orders that meet specified conditions and are recorded and reported to OATS by another member, and permit NASD to grant exemptive relief from the OATS reporting requirements to members that meet specified criteria. The SIA has worked with NASD and the Securities and Exchange Commission (“SEC”) for many years on the development of OATS and we appreciate the opportunity to provide industry input during Phase 3 of OATS implementation.

At the outset, the SIA notes the amount of time between publication of the original proposal and Amendment No. 2 demonstrates the considerable effort undertaken to address the challenges presented by the proposal. Clearly, NASD and the SEC have

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<sup>1</sup> The Securities Industry Association brings together the shared interests of more than 550 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated an estimated \$227.5 billion in domestic revenue and \$305 billion in global revenues. (More information about SIA is available at: [www.sia.com](http://www.sia.com).)

thoughtfully considered the concerns raised by the industry.<sup>2</sup> The industry also has responded by significantly increasing the automation of order transmissions over the last several years. As a result, a higher percentage of orders are electronic and, therefore, currently are captured by OATS. Nevertheless, some firms will continue to transmit orders manually and additional systems changes will be required to integrate various different platforms into a single system to comply with the proposed dual reporting requirements under OATS Phase 3.

Notwithstanding the above, additional programming will be needed for firms to properly report dual receipt times for both manual and electronic orders and to report additional order routing information. Therefore, the SIA respectfully requests that the NASD (1) promptly publish the technical specifications; (2) extend the proposed implementation date from 120 days to six months from the date the technical specifications are published; and (3) conduct a series of conference calls and/or forums during the implementation period to answer technical and/or interpretive questions; and (4) propose a carve-out or phased implementation for preferred and convertible securities.

### **Order Receipt and Route Information**

Currently, the OATS Rules apply only to electronic orders and provide that the time of receipt for an electronic order is the time the order is received by a firm's electronic order handling system. In Amendment No. 2, NASD proposes to amend its definition of time of receipt to include manual orders<sup>3</sup> and to require firms, for both manual and electronic orders, to capture and transmit both the time the order is received from the customer and the time the order is received by the member's trading desk or trading department, if those times are different. Because orders may be routed to multiple locations within a firm prior to reaching the trading desk, NASD also is proposing to capture the various receipt times (customer receipt time, trading desk receipt time, etc.) by expanding the OATS order transmittal requirements that apply to intra-firm routes, *i.e.*, desk reports. With respect to intra-firm routes, the proposed rule change would require members to provide information on the nature of the department to which an order is transmitted, the number of shares to which the transmission applies, and any special handling requests. NASD indicates that the *OATS Reporting Technical Specifications* will specify how firms should report this information.

While NASD amended the initial proposal based upon industry comments regarding the burdens of a bifurcated time of receipt for manual orders over or under 10,000 shares, the current proposal to capture and report dual receipt times (if applicable) and desk route information for both manual and electronic orders is a material change

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<sup>2</sup> See letter to Margaret McFarland, Deputy Secretary, U.S. Securities and Exchange Commission, from Stuart J. Kaswell, Senior Vice President and General Counsel, SIA, dated October 24, 2000.

<sup>3</sup> NASD Rule 6951(i) defines a "Manual Order" as "an order that is captured by a member other than in an electronic order-routing or execution system."

from the initial filing requiring additional programming by members and, therefore, warrants a longer implementation period for firms to comply with these new reporting requirements. The SIA believes the below recommendations will ease firms' compliance burdens while ensuring a more efficient transition into OATS Phase 3.

First, the SIA requests that NASD promptly publish the technical specifications for OATS Phase 3. Firms may receive orders on several different platforms. For example, orders may be received through single or multiple Internet applications and through any number of different front-end systems designed for particular trading desks within the firm.<sup>4</sup> Considerable programming is necessary to integrate the multitude of systems in order for a firm to achieve a single OATS transmission. In addition, while the proposed rule change sets forth a broad outline of what information firms would be required to report, the large majority of technical requirements relating to OATS are found in the technical specifications, as acknowledged by NASD.<sup>5</sup> Specifically, the filing states that details regarding intra-firm routes will be provided in the technical specifications. Firms' experience with the OATS Rules over the last seven years has shown that little programming can commence until final technical specifications are issued. Therefore, prompt publication of the technical specifications is critical to enable firms to timely commence any necessary systems modifications.

Secondly, the SIA requests that NASD extend the proposed implementation date from 120 days to six months from the date the technical specifications are published. The SIA acknowledges and appreciates NASD's recognition of the technological burden required to comply with the proposed rule change.<sup>6</sup> As the industry becomes increasingly reliant on technology, the SIA believes that adequate time for implementation and testing is critical to avoid future compliance problems. Therefore, the SIA believes that six months from the date of publication of the technical specifications would be a reasonable implementation timetable. During at least three of the six months, the SIA suggests NASD make available an active test site where firms can test in a live environment. While NASD itself has proposed 120 days for implementation, the SIA believes an additional 60 days is reasonable in light of the extensive interfaces that firms must construct and test as a result of the significant amendments made to the proposal since it was initially filed in 2000.

Third, the SIA requests that NASD conduct a series of conference calls and/or forums during the implementation period to answer technical and/or interpretive questions. Technological solutions often produce unforeseen results. NASD should consider, as they have done in other contexts, conducting a series of conference calls open to the entire industry to answer technical and/or interpretive questions. The

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<sup>4</sup> One large wirehouse indicated that it has at least 12 such platforms.

<sup>5</sup> See 70 FR at 36988.

<sup>6</sup> See 70 FR at 36989.

outcome of the calls may be posted to NASD's website as "frequently asked questions" or "Q&As," to ensure uniform application of the technical specifications and consistent compliance across firms. The SIA believes a series of conference calls and/or forums hosted by NASD during the implementation period would greatly assist firms in effectively implementing the required technical changes to comply with OATS Phase 3 and we believe the SEC should affirmatively require such initiatives.

### **Preferred and Convertible Securities**

The SIA strongly supports NASD withdrawing the portion of the proposal requiring members to capture and report a transmitting member's identifier for manually routed orders. For certain firms and order types, orders will continue to be transmitted manually. In such cases, reliable and efficient transmission of identification numbers will remain a challenge. For example, preferred securities and convertible securities are equity securities under the Rules and, as such, are subject to OATS reporting. These securities typically trade like fixed income securities in a largely manual way, including manual order entry, routing and execution, and are entered into an electronic system only after the trade is done for purposes of trade reporting and clearance and settlement.

We expect that the exception for manually-routed orders, the proposed change to the definition of "Reporting Member," and the availability of exemptive relief will ameliorate some of the problems associated with manual orders, and will encourage firms to pursue further automated order transmission solutions. Until more progress is made in automating order transmission for preferred and convertible securities, however, the NASD is likely to receive numerous exemption requests in connection with these securities. Therefore, the SIA suggests NASD propose a carve-out or phased implementation for such securities to minimize the impact of Phase 3's implementation.

### **Routed Order Identifier**

SIA strongly supports NASD's decision to exempt manually-routed orders from the unique order identifier requirement. The SIA believes this decision will limit delays in order communication and execution, which could have harmed public customers.

### **Reporting Member Exclusion and Exemptive Relief**

The proposed rule change would exclude certain members from the definition of "Reporting Member" for orders that meet specified conditions and are recorded and reported to OATS by another member.<sup>7</sup> The proposal also would permit the NASD to

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<sup>7</sup> The conditions require: (1) a non-discretionary order routing process, pursuant to which the member routes **all** of its orders to a single receiving Reporting Member; (2) no control over subsequent routing or execution by the receiving Reporting Member; (3) the receiving Reporting Member to record and report all information required under Rules 6954 and 6955; and (4) a written agreement with the receiving Reporting Member.

grant exemptive relief from the OATS reporting requirements in certain circumstances to members that meet specified criteria.<sup>8</sup>

The SIA has previously urged the NASD to extend an exemption to all reporting firms based on the number of manual orders they handle as a percentage of total volume, which would be viewed separately for each type of security.<sup>9</sup> Although we continue to believe that the conditions proposed may be unduly restrictive, we note that NASD has undertaken to review and analyze the application of the conditions and seek changes to the conditions, including the types of changes suggested by commenters, if the proposed rule change is approved. In the interim, the SIA believes a specific exemption or phased implementation for preferred and convertible securities would address investor protection concerns, particularly for those firms that, due to their size or business mix, may not meet the conditions for exemptive relief.

## **Conclusion**

The industry has been aware for many years of the expectations of regulators with respect to full implementation of OATS. Consequently, since the filing of the original proposal, firms have been diligently working to automate the order transmission process. Much progress has been made but more remains to be done. Systems must be modified so that disparate platforms can “hand off” the information that is required to be recorded for reporting to the NASD. Therefore, in light of the newly proposed reporting requirements in Amendment No. 2, the SIA urges the SEC to approve an implementation date of six months, rather than 120 days, from the publication of the relevant update to the *OATS Reporting Technical Specifications*.

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<sup>8</sup> NASD staff, for good cause shown after taking into consideration all relevant factors, may exempt, subject to specified terms and conditions, a member from the order transmission requirements of OATS for manual orders, if such exemption is consistent with the protection of investors and the public interest, and the member meets the following criteria: (A) no final disciplinary actions within the last five years, or ten years for any final disciplinary action involving fraud; (B) annual revenues of less than \$2 million; (C) no market making activities in Nasdaq Stock Market equity securities; (D) generally, no principal transactions with customers; and (E) no clearing or carrying activities for other firms.

<sup>9</sup> *Supra* note 2.

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Thank you for the opportunity to comment. If you have questions or would like to discuss our comments further, please contact the undersigned or Richard Bommer, SIA Assistant Vice President and Director of Operations, at 212.608.1500.

Sincerely,

Ira D. Hammerman  
Senior Vice President and  
General Counsel

CC: Annette L. Nazareth, Director, Division of Market Regulation  
Robert L.D. Colby, Deputy Director, Division of Market Regulation  
SIA Self-Regulation and Supervisory Practices Committee  
SIA Operations Committee