

# FIA PTG

## PRINCIPAL TRADERS GROUP

2001 K Street NW, Suite 725, Washington, DC 20006 | Tel +1 202.466.5460

June 13, 2023

Vanessa Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Re: Regulation Systems Compliance and Integrity, Release No. 34-97143; File No. S7-07-23

Dear Ms. Countryman:

The FIA Principal Traders Group (“FIA PTG”)<sup>1</sup> appreciates the opportunity to submit this letter to the Securities and Exchange Commission (“SEC” or the “Commission”) in response to the above-captioned rule proposal (the “Reg SCI Proposal or Proposal”).<sup>2</sup> We are concerned that the Reg SCI Proposal fails to clearly articulate the justification for expanding Reg SCI to broker-dealers nor does it consider the significant impact of the rule on competition.

Specifically, the Reg SCI Proposal does not fully incorporate the substantive requirements of the current guidance on economic analysis which require staff of the rulemaking divisions to:

1. Clearly identify the justification for the rule.
2. Define the baseline against which to measure the proposed rule’s economic impact.
3. Identify and discuss reasonable alternatives to the rule.
4. Analyze the economic consequences of the proposed rule and regulatory alternatives.<sup>3</sup>

We examine the issues with the Proposal’s ability to meet these requirements in the discussion below.

---

<sup>1</sup> FIA PTG is an association of firms, many of whom are broker-dealers, who trade their own capital on exchanges in futures, options and equities markets worldwide. FIA PTG members engage in manual, automated and hybrid methods of trading, and they are active in a wide variety of asset classes, including equities, fixed income, foreign exchange and commodities. FIA PTG member firms serve as a critical source of liquidity, allowing those who use the markets, including individual investors, to manage their risks and invest effectively. The presence of competitive professional traders contributing to price discovery and the provision of liquidity is a hallmark of well-functioning markets. FIA PTG advocates for open access to markets, transparency and data-driven policy.

<sup>2</sup> See Regulation Systems Compliance Integrity, Exchange Act Release No. 97143 (Mar. 15, 2023) [88 FR 23146 (Apr. 14, 2023)] (“Reg SCI Proposal”).

<sup>3</sup> See Memorandum from the Division of Risk, Strategy, and Financial Innovation and the Office of the General Counsel, Current Guidance on Economic Analysis in SEC Rulemakings (Mar. 16, 2012), *available at* [https://www.sec.gov/divisions/riskfin/rsfi\\_guidance\\_econ\\_analy\\_secrulemaking.pdf](https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf).

**Overview: The Commission has not justified expanding Reg SCI to broker-dealers nor has it adequately considered alternatives and the impact on competition.**

With the ubiquity of electronic trading, vigorous competition has produced operationally resilient U.S. securities markets that are the largest and most innovative in the world. This operational resiliency has been proven time and time again as our securities markets have weathered natural disasters, the pandemic, and significant technological change. Below is a summary of our comments:

- **Expanding Reg SCI to broker-dealers is not justified by actual market experience.** The Commission does not satisfy its obligation to justify this proposal with any data - there is not a single market event that has occurred necessitating the application of Reg SCI to broker-dealers. While the Market Access Rule has a different focus than Reg SCI, no attempt is made to explain why the rule is insufficient. Similarly, the widespread adoption of industry best practices has been effective at addressing control frameworks and reasonably designed policies and procedures.
- **Using a 10% transaction activity threshold does not achieve the Commission's goal of preventing market-wide disruptions.** The Commission does not establish a causal link between broker-dealers with high transaction activity and market disruptions. Our current market structure promotes resilience with the ability to seamlessly switch between principal trading firms with low costs due to the substitutability of these services across our markets. If addressing concentration risk is the goal, the Commission needs to take a more granular approach and consider business lines within the markets.
- **The current regulatory baseline includes a robust framework of SRO rules and guidance that already address operational resiliency.** The regulatory baseline did not include a discussion of rules and guidance associated with SRO membership, market maker obligations or trade reporting. These address many of the purported concerns mentioned in the Proposal.
- **The Commission should explore alternatives that reduce the high regulatory burden on SCI broker-dealers.** There are a range of other ways to address this issue if the Commission truly believes there is a problem. Identifying alternatives is particularly important given the economic impacts that the current Reg SCI Proposal would have.
- **Economic consequences including the impact on competition are not necessary or appropriate. Compliance for SCI broker-dealers will be extremely costly.** The discussion of competition among broker-dealers has not been addressed. We have several areas of concern including the impact on innovation, operating from geographically diverse back-up locations, the potential for information leakage and the ability for broker-dealers to scale. Given the all-encompassing scope of SCI systems, SCI broker-dealers will be singled out as the only broker-dealers to incur costs, without corresponding market benefits, as a result of onerous reporting, notification, and operational requirements.

Forcing SCI broker-dealers to resume trading within a day is inconsistent with market maker obligations established by SRO rules which maintain a reasonableness standard for transacting on an exchange in accordance with the maintenance of fair and orderly markets.

FIA PTG recommends the Commission seek alternatives to the Reg SCI Proposal that are less burdensome and anti-competitive. At a minimum, the Commission should perform additional economic analysis and offer a further opportunity for comment.<sup>4</sup>

\*\*\*\*\*

### **Expanding Reg SCI to broker-dealers is not justified by actual market experience.**

FIA PTG agrees with the Commission that operational resiliency across market participants is essential to maintaining investor confidence and orderly markets. Avoiding market-wide disruptions is prudent for both individual firms and the markets as a whole. Given the success of the markets during times of stress including COVID and high market volatility, we believe the markets have demonstrated operational resiliency and question the need for expanding Reg SCI to broker-dealers.

#### ***Current Market Structure Promotes Resiliency and Prevents Adverse Effects***

The Reg SCI Proposal covers several markets all of which are highly electronic. In each of these markets, there are many trading alternatives to an SCI broker-dealer if such a firm was experiencing operational issues. The Proposal identifies potential adverse effects associated with issues at SCI broker-dealers including interruptions in the price discovery process and liquidity flows and slow executions or delayed orders with cascading effects disruptive to the broader market.”<sup>5</sup> However, it does not discuss how the automated nature of our market structure with significant competition for order flow mitigates such adverse effects given the high degree of substitutability and low switching costs as it relates to principal trading. Simply put, the expansion of Reg SCI to broker-dealers is a solution in search of a problem.

In the Reg SCI Proposal, the Commission questions the ability of the markets to accommodate order flow from an SCI broker-dealer that leaves the market stating:

“Capacity constraints, whether due to risk management, or operational capability limitations of systems, could limit how much one broker-dealer could handle a sudden increase in order flow from a large broker-dealer.”<sup>6</sup>

However, all the order flow from an SCI broker-dealer would not go to a single market participant. Rather, that order flow would be distributed among many market participants without a significant

---

<sup>4</sup> This would be consistent with prior Commission action e.g., Supplemental Information and Reopening of Comment Period for Amendments to Exchange Act Rule 3b-16 Regarding the Definition of “Exchange” (Apr. 14, 2023), [88 FR 29448 (May 5, 2023)].

<sup>5</sup> See Reg SCI Proposal, 88 FR 23163

<sup>6</sup> See Reg SCI Proposal, 88 FR at note 197

impact on capacity. The most notable effect of such a scenario would likely be much higher fill rates for the numerous broker-dealers benefiting from the additional order flow.

While market structure differs across the markets covered by the rule, routing broker-dealers maintain multiple connections to execution venues, that may include broker-dealers, exchanges and ATSS, that allow them to seamlessly transfer order flow between market centers. Additionally, broker-dealers have well-established procedures to alert their clients and counterparties of a system issue.

In addition to the resiliency provided by electronic order routing, the fact that our market structure requires all broker-dealers to be members of an exchange or FINRA also promotes resiliency. While not discussed in the Reg SCI Proposal, exchange member rules,<sup>7</sup> market maker obligations<sup>8</sup> and FINRA reporting guidance<sup>9</sup> all require operational robustness on the part of their members including SCI broker-dealers as does the Market Access Rule which is discussed in more detail below.

***The Market Access Rule Already Addresses Incidents that May Cause Market-wide Disruptions***

Whereas a broker-dealer can have an issue without impacting the markets, there is the potential for market disruption when a broker-dealer fails to apply financial or regulatory controls when trading on an exchange or ATS. The Market Access Rule is intended to address these scenarios and has succeeded in bringing enforcement action when appropriate. Notably, the system issues encountered by Knight Capital led to enforcement action and the press release at the time indicated the enforcement goals with respect to the rule:

“Brokers and dealers must look at each component in each of their systems and ask themselves what would happen if the component malfunctions and what safety nets are in place to limit the harm it could cause. Knight Capital’s failure to ask these questions had catastrophic consequences.”<sup>10</sup>

---

<sup>7</sup> See e.g., Nasdaq Stock Market Rule 1013 (a)(1)(H) requiring new members to provide “a description of the communications and operational systems the Applicant will employ to conduct business and the plans and procedures the Applicant will employ to ensure business continuity, including: system capacity to handle the anticipated level of usage; contingency plans in the event of systems or other technological or communications problems or failures; system redundancies; disaster recovery plans; and system security;”

<sup>8</sup> See e.g., CBOE BZX Exchange Rule 11.8 Obligations of Market Makers, Interpretation .02(c) Qualifications of a CLP: “To qualify as a CLP, a Member must be a registered Market Maker in good standing with the Exchange consistent with Rules 11.5 through 11.8 and must have: (1) Adequate technology to support electronic trading through the systems and facilities of the Exchange; ... (3) Adequate trading infrastructure to support CLP trading activity, which includes support staff to maintain operational efficiencies in the CLP program and adequate administrative staff to manage the Member’s participation in the CLP program;”

<sup>9</sup> See e.g., FINRA Trade Reporting FAQ 206.21 “...firms must have sufficiently robust systems with adequate capability and capacity to enable them to report in accordance with FINRA rules, including reasonable back-up capabilities in the event of a systems issue in the firm's or a vendor's systems.”

<sup>10</sup> See SEC Charges Knight Capital With Violations of Market Access Rule, (Oct. 16, 2013), available at <https://www.sec.gov/news/press-release/2013-222>

Enforcement of the Market Access Rule that requires broker-dealers to look at “each component of each system” is expansive enough to cover SCI systems. While the Reg SCI Proposal contends that the Market Access Rule serves a different purpose than the Reg SCI Proposal, it does not articulate in what cases an SCI event that is not related to market access could cause market-wide disruption.

***Application of Industry Best Practices Promotes Operational Resiliency***

FIA PTG has long advocated for the need for risk controls for all electronic trading activity. In March 2015, FIA PTG contributed to the publication of the Guide to the Development and Operations of Automated Trading Systems<sup>11</sup> to define industry best practices specifically addressing many aspects of Reg SCI’s operational resiliency requirements. With respect to the elements of the Reg SCI Proposal, the Guide covers the following:

- Pre-trade controls including market data reasonableness checks
- Disaster recovery/business continuity
- System development, testing (including load and stress testing), and change management
- Systems operations including monitoring, failure detection and recovery
- Security including cyber, access controls and vendor management
- Documentation of policies, procedures, and systems

While the Reg SCI Proposal states that market incentives are inadequate to address operational resiliency, it makes no mention of these well-developed industry best practices that have been in place and adhered to for many years.

**Using a 10% transaction activity threshold does not achieve the Commission’s goal of preventing market-wide disruptions.**

The basis for expanding Reg SCI to broker-dealers with high transaction volume is the assertion that these firms are critical to the maintenance of fair and orderly markets. Transaction volume is being used as a proxy for the potential for adverse effects without actually demonstrating that link with empirical evidence. If, in fact, the Commission believes that concentration risk needs to be addressed via a rule on operational resiliency, a more nuanced analysis of our marketplace is required to identify single or highly concentrated points of failure that truly impact the ability for the markets to function, e.g., order lifecycle functions where there is no ability to seamlessly failover to another provider. Such a nuanced view would also need to look across various lines of business within trading firms to determine the extent to which a problem in one business line has the ability to impact another. Larger, more diversified businesses typically support different business lines with unique systems, and a disruption in one area is unlikely to impact another. The

---

<sup>11</sup> See Guide to the Development and Operations of Automated Trading Systems, (Mar. 2015), available at <https://www.fia.org/sites/default/files/2020-03/Guide%20to%20the%20Development%20and%20Operation%20of%20Automated%20Trading%20Systems%20%28March%202015%29.pdf>

broad-based activity threshold fails to consider a business line approach that might reveal true concentration risk and instead targets large, diversified broker-dealers.

While we do not believe transaction activity at any threshold is the right metric, the Proposal offers no rationale for any one transaction activity threshold. In considering thresholds based on a 15% transaction activity threshold, the Proposal states the Commission “determined that this would fail to scope within Regulation SCI some of the largest and most significant broker-dealers that pose technological vulnerabilities and risks to the maintenance of fair and orderly markets.”<sup>12</sup> This logic indicates that the choice of a 10% threshold over a 15% threshold was arbitrary and based on factors other than transaction activity.

**The current regulatory baseline includes a robust framework of SRO rules and guidance that address operational resiliency.**

There is a robust SRO regulatory framework in place that is largely dismissed as being insufficient to address operational resiliency even though the value of imposing more stringent requirements is not discussed. For example, FINRA Rule 4370 is found to be inadequate because it does not require next day resumption of trading or two-hour recovery for critical SCI systems. However, as discussed in more detail below, forcing SCI broker-dealers to resume operations without a reasonableness standard is a significant departure from SRO market maker obligations and has the potential to increase operational risk and negatively impact liquidity provision.

Similarly, FINRA Rule 4530 is dismissed because it does not cover system disruptions or intrusions that do not violate any securities law. However, it is unclear which disruptions or intrusions actually fall outside of this parameter and the extent to which non-violative system disruptions or intrusions would result in market disruptions. At no point in the Reg SCI Proposal have inadequacies in our current regulatory framework been identified that resulted in an actual market incident.

While a regulatory baseline is defined in the Reg SCI Proposal, there is no discussion of “what the world will be like if the proposed rule is not adopted.”<sup>13</sup> The only mention of identified failings comes from a discussion of OCIE’s 2017 Observations from Cybersecurity Exams.<sup>14</sup> However, it is impossible to determine the extent to which that sweep represented SCI broker-dealers. In contrast, evidence from FINRA’s 2018 Cybersecurity Report,<sup>15</sup> indicates that higher revenue firms

---

<sup>12</sup> See Reg SCI Proposal, 88 FR 23264.

<sup>13</sup> See Memorandum from the Division of Risk, Strategy, and Financial Innovation and the Office of the General Counsel, Current Guidance on Economic Analysis in SEC Rulemakings (Mar. 16, 2012), at note 21, available at [https://www.sec.gov/divisions/riskfin/rsfi\\_guidance\\_econ\\_analy\\_seculemaking.pdf](https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_seculemaking.pdf).

<sup>14</sup> See OCIE, SEC, *Observations from Cybersecurity Examinations* (Aug. 7, 2017), available at <https://www.sec.gov/files/observations-from-cybersecurity-examinations.pdf>.

<sup>15</sup> See FINRA Report on Selected Cybersecurity Practices – 2018 (Dec. 2018), available at [https://www.finra.org/sites/default/files/Cybersecurity\\_Report\\_2018.pdf](https://www.finra.org/sites/default/files/Cybersecurity_Report_2018.pdf).



have high cybersecurity standards, citing results from their 2017 Risk Controls Assessment survey focused on higher revenue firms:

- 100% of higher revenue firms include penetration testing as a component in their overall cybersecurity program.
- 94% of higher revenue firms use a risk assessment as part of their cybersecurity program.

We believe the proposed Cybersecurity Risk Management Proposal<sup>16</sup> should address these concerns as it is specifically focused on the cyber issues covered by the Risk Alert.

### **Reasonable Alternatives That Would Reduce Regulatory Burden Are Not Fully Explored.**

Reasonable alternatives to expanding the scope of Reg SCI to include broker-dealers are not substantively considered by the Reg SCI Proposal. FIA PTG notes that the alternative which considers limiting the scope of Reg SCI provisions for new SCI entities focuses only on Security-Based Swap Data Repositories (“SBSDRs”) and does not explore this alternative with respect to broker-dealers.

We think there are many other alternatives which the Commission should have considered and analyzed from a cost-benefit perspective. These include:

- Expand the scope of the proposed Cybersecurity Risk Management Proposal to include general resiliency. Cybersecurity is already addressed.
- Enhance the Market Access Rule as necessary once justification for further rulemaking is provided.
- Adopt a principles-based approach to operational resiliency drawing on industry best practices like the Guide to the Development and Operations of Automated Trading Systems.
- If investor access to markets is the problem that the Commission is trying to solve, consider rulemaking to require routing broker-dealers to have connections and agreements to multiple execution venues.
- Require SROs to strengthen existing operational resiliency regulatory frameworks considering the timeliness of disclosures and dissemination of such disclosures to SEC staff regarding market participant outages or disruptions.

The benefit of all these alternatives over the current Proposal would likely be a lower regulatory burden with a reduced impact on competition.

---

<sup>16</sup> See Cybersecurity Risk Management Rule for Broker-Dealers, Clearing Agencies, Major Security-Based Swap Participants, the Municipal Securities Rulemaking Board, National Securities Associations, National Securities Exchanges, Security-Based Swap Data Repositories, Security-Based Swap Dealers, and Transfer Agents, Exchange Act Release No. 97142 (Mar. 15, 2023) [88 FR 20212 (Apr. 5, 2023)] (Cybersecurity Risk Management Proposal”).

**Economic Consequences Including the Impact on Competition are Not Necessary or Appropriate. Compliance for SCI broker-dealers will be extremely costly.**

While the Proposal acknowledges that compliance costs could impact the profitability of SCI broker-dealers, it fails to discuss the significance of this burden and several other aspects of the rule's implementation including far-reaching impacts on competition. Across our securities markets, a handful of firms will be subject to Reg SCI's initial and ongoing costs at a stark disadvantage to other market participants that offer the same services. We are concerned that the Commission has not met its obligation under Section 23(a)(2) of the Exchange Act and believe that further analysis would confirm that the Proposal as it stands imposes a burden on competition that is not necessary or appropriate.

***Business Continuity Policies & Procedures Requiring Geographical Diversity and Next Day Resumption of Trading are Costly and Ineffective***

The business continuity provisions of Rule 1001(a)(2)(v) will force SCI broker-dealers to establish business continuity capabilities that are geographically diverse and reasonably designed to achieve next day resumption of trading. Not only is this requirement costly, it also puts SCI broker-dealers at a serious disadvantage if they are required to resume trading at locations away from exchange data centers. In practice, these backup systems and locations would be largely useless for SCI broker-dealers given the competitive implications of operating from a far-away location while other market participants continue to operate from co-located sites.

Requiring next business day resumption is also a concerning departure from the reasonableness standard established by all SRO market maker rules.<sup>17</sup> The Commission offers no justification for moving away from a risk-based framework and forcing principal trading firms to commit capital. All broker-dealers, not just Reg SCI broker-dealers, should be incentivized to resume trading when, and only when, they feel operationally ready. In the absence of benefits, the costs and resulting impact on SCI broker-dealers vis-a-vis their competition is deeply concerning and is not addressed in the Proposal.

It is worth noting that we do not believe SCI broker-dealers operate any critical SCI systems. If this rule is adopted, we respectfully request confirmation that this is correct.

***Reporting of SCI Broker-dealer's SCI Systems & Material Changes Raises Concerns Regarding Information Leakage to Competitors***

Rule 1003(b) requires SCI broker-dealers to prepare and submit to the SEC a review of all SCI systems including proprietary and confidential details pertaining to, among other elements, internal

---

<sup>17</sup> See e.g., CBOE Rule 5.51(a) (requiring market makers to have "dealings reasonably calculated to contribute to the maintenance of a fair and orderly market"), Nasdaq PHLX Rule Section 4 (requiring market makers to have "dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and those member organizations should not make bids or offers or enter into transactions that are inconsistent with such course of dealings."), NYSE American Rule 7.23E (a) (requiring market makers to have "dealings for their own account to assist in the maintenance, insofar as reasonably practicable, of fair and orderly markets."



control design and operational effectiveness. For principal trading firms, these systems include intellectual property that is commercially very valuable, and its competitive value is lost if the information is disclosed. Similarly, the reporting of material systems changes would expose functionality changes to software that embodies trade secrets at principal trading firms. While material system change reporting is quarterly, there is also a requirement to “promptly submit a supplemental report notifying the Commission of a material error in or material omission from the quarterly report.”<sup>18</sup> We anticipate material system changes on a frequent basis given the pace of innovation at our member firms.

Comprehensive knowledge of an SCI broker-dealer's systems is closely held even within an SCI broker-dealer. We see no compelling reason why the SEC should be able to access highly confidential intellectual property without making a reasonable showing of cause and obtaining a subpoena. We believe our concerns about information leakage associated with SEC reporting are justified in light of the GAO report that stated 4.6% of mission-critical staff at the SEC left in FY2021 including 13.9% of senior officers who resigned presumably to seek employment elsewhere.<sup>19</sup> Critically, hampering FIA PTG members' ability to protect their intellectual property from disclosure to competitors jeopardizes the liquidity of the U.S. financial markets. Typically, the software employed to run their trading systems has been developed and is continually refined by the firms themselves, not purchased or licensed from a third party. As discussed above, the Proposal gives no indication of how the Commission has or will use this information in furtherance of the Proposal's objectives.

### ***Thresholds Create an Artificial Ceiling Impacting Broker-Dealers Growth***

Activity and asset-based thresholds have the potential of stifling growth for broker-dealers who are concerned about the regulatory burden associated with becoming an SCI broker-dealer. We believe the effect of these thresholds will be antithetical to addressing the Commission's concerns with concentration risk. In order to avoid Reg SCI, broker-dealers that could scale will choose not to. One data point supporting this conclusion is that at the time of the adoption of Reg NMS there were fourteen SCI ATSS but today there are only seven.<sup>20</sup>

If the Commission believes additional policies and procedures and reporting are required, FIA PTG recommends a less burdensome approach that applies to all broker-dealers, similar to the Cybersecurity Risk Management Proposal.

\*\*\*\*\*

FIA PTG encourages the SEC to explore the alternatives identified and seek input from market participants. If a reproposal is not contemplated, then at a minimum the Commission should release

---

<sup>18</sup> See Reg SCI Proposal, Rule 1003

<sup>19</sup> See GAO, *Securities And Exchange Commission: Employee Views of Personnel Management Improved, but Action Needed on Measuring Diversity and Inclusion Goals*, [GAO-23-105459](#), (Washington, D.C.: Dec. 22, 2022).

<sup>20</sup> See 79 FR 72373 and 88 FR 23266.

additional economic analysis to support its recommendation. We note that when the Commission first proposed Reg SCI, the Commission conducted a roundtable entitled “Technology and Trading: Promoting Stability in Today’s Markets and sought feedback from panelists and through an open comment file.<sup>21</sup> FIA PTG would welcome the opportunity to discuss operational resiliency in a similar forum. If you have any questions, please do not hesitate to contact Joanna Mallers at [jmallers@fia.org](mailto:jmallers@fia.org).

Respectfully,

FIA Principal Traders Group

A handwritten signature in blue ink that reads "Joanna Mallers". The signature is written in a cursive, flowing style.

Joanna Mallers  
Secretary

cc: Gary Gensler, Chair  
Hester M. Peirce, Commissioner  
Caroline A. Crenshaw, Commissioner  
Mark T. Uyeda, Commissioner  
Jaime Lizárraga, Commissioner

---

<sup>21</sup> See Securities Exchange Act Release No. 67802 (September 7, 2012), 77 FR 56697 (Sept. 13, 2012) (File No. 4-652). A webcast of the Roundtable is available at: [www.sec.gov/news/otherwebcasts/2012/ttr100212.shtml](http://www.sec.gov/news/otherwebcasts/2012/ttr100212.shtml).