

# PAPERWORK REDUCTION ACT SUBMISSION

## 17 CFR 240.19b-5 and Form PILOT

### SUPPORTING STATEMENT

#### **A. Justification**

##### 1. Necessity of Information Collection

The Securities Exchange Act of 1934, as amended (“Act”),<sup>1</sup> sets forth a scheme of self-regulation under which national securities exchanges, national securities associations, and registered clearing agencies have primary responsibility for regulating their members or participants. Under this scheme, the Commission's role is primarily one of oversight; the Act charges the Commission with the responsibility for assuring that each of these self-regulatory organizations (“SROs”) complies with and advances the policies of the Act. As part of its oversight responsibilities, the Commission is required to review changes in the rules of the various SROs.

Section 19(b) of the Act<sup>2</sup> requires each SRO to file with the Commission copies of any proposed amendment to its constitution, articles of incorporation, bylaws, rules or similar instrument or any interpretation of these instruments (collectively, “rule changes”). The Commission is required to publish notice of any such filing, and then either to approve the rule change or institute proceedings to determine whether the rule change should be disapproved. Rule 19b-4<sup>3</sup> implements the requirements of Section 19(b) of the Act by requiring SROs to file their rule changes on Form 19b-4 and by clarifying which actions by SROs must be filed pursuant to Section 19(b). Rule 19b-4 was adopted in 1975 pursuant to Sections 2, 3, 6, 11A, 15A, 15B, 17, 19, and 23 of the Act.

Rule 19b-5 under the Act<sup>4</sup> provides a temporary exemption from the rule-filing requirements of Section 19(b) of the Act to SROs wishing to establish and operate pilot trading systems. Certain provisions of Rule 19b-5 contain collection of information requirements within the meaning of the Paperwork Reduction Act of 1995<sup>5</sup> through the use of Form PILOT. Rule 19b-5 permits an SRO to develop a pilot trading system and to begin operation of such system shortly after submitting an initial report on Form PILOT to the Commission. During operation of the pilot trading system, the SRO must submit quarterly reports of the system’s operation to the Commission on Form PILOT, as well as timely amendments on Form PILOT describing any material changes to the system. After two years of operating such pilot trading system under the

<sup>1</sup> 15 U.S.C. 78a et seq.

<sup>2</sup> 15 U.S.C. 78s(b).

<sup>3</sup> 17 CFR 240.19b-4.

<sup>4</sup> 17 CFR 240.19b-5.

<sup>5</sup> 44 U.S.C. 3501 et seq.

exemption afforded by Rule 19b-5, the SRO must submit a rule filing pursuant to Section 19(b)(2) of the Act<sup>6</sup> in order to obtain permanent approval of the trading system from the Commission.

## 2. Purpose of, and Consequences of Not Requiring, the Information Collection

The purpose of Rule 19b-5 is to provide a temporary exemption from rule-filing requirements to SROs wishing to begin operation of a pilot trading system. In the absence of this exemption, an SRO would be required to submit a proposed rule change to the Commission pursuant to Section 19(b) of the Act and Rule 19b-4 thereunder in order to operate any new trading system. Section 19(b) of the Act generally requires SROs to file with the Commission copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such SRO. Once a proposed rule change has been filed, the Commission must publish notice of its receipt and allow an opportunity for the public to comment on it. A proposed rule change may not take effect unless it is approved by the Commission or is otherwise permitted to become effective under Section 19(b) of the Act. Section 19(b)(3) of the Act<sup>7</sup> provides that, in certain circumstances, a proposed rule change may become effective immediately upon filing with the Commission without certain of the procedures required by Section 19(b)(2). In order to approve a rule change proposing a new trading system, the Commission would be required to find that, among other things, such trading system will serve to promote the public interest and help to remove impediments to a free and open securities market in accordance with the requirements of Section 6(b)(5)<sup>8</sup> of the Act. Further, pursuant to Section 3(f) of the Act,<sup>9</sup> the Commission would have to find that the proposed trading system will serve to protect investors and promote efficiency, competition and capital formation.

Rule 19b-5 permits an SRO to operate a pilot trading system immediately, without requiring any Commission findings, provided that such system is in compliance with the conditions set forth in Rule 19b-5. In order for the Commission to maintain an accurate record of all new pilot trading systems operated by SROs and to determine whether an SRO has properly availed itself of the exemption afforded by Rule 19b-5, it is necessary that an SRO file a Form PILOT in conjunction with the operation of a new pilot trading system, providing the Commission with at least 20 days' notice before commencing operations. In addition, in order for the Commission to determine whether an SRO operating a pilot trading system pursuant to the exemption afforded by Rule 19b-5 is operating such system in compliance with the Act and is carrying out its statutory oversight obligations under the Act, it is necessary that an SRO submit quarterly reports of the system's operation and amendments describing material changes to the system to the Commission on Form PILOT. The Commission will review SRO compliance with Rule 19b-5 and other provisions of the Act through its routine inspections and examinations.

SROs provide information on Form PILOT relating to the operation of their pilot trading systems. SROs also use Form PILOT to notify the Commission of changes to such systems and to

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<sup>6</sup> 15 U.S.C. 78s(b)(2).

<sup>7</sup> 15 U.S.C. 78s(b)(3).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> 15 U.S.C. 78c(f)

make quarterly reports of their operations. Without such information, the Commission might not have sufficient information to ensure that the pilot trading system continued to operate in a manner consistent with the Act.

3. Role of Improved Information Technology and Obstacles to Reducing Burden

The compilation and filing of the data required reflects the complexity of the SROs' businesses. Thus, improved technology would not reduce the burden.

4. Efforts to Identify Duplication

Not applicable. The Commission believes that no duplication of the requirements of Rule 19b-5 exists. Additionally, the Commission notes that Rule 17a-1 under the Act<sup>10</sup> currently contains recordkeeping requirements for SROs. Although Rule 19b-5 does not create new recordkeeping obligations for SROs, paragraph (e)(9) of Rule 19b-5<sup>11</sup> reiterates the SROs' existing recordkeeping obligations under Rule 17a-1.

5. Effects on Small Entities

Not applicable. The SROs who are required to respond to the collection of information are not small businesses.

6. Consequences of Less Frequent Collection

Rule 19b-5 requires that information describing a pilot trading system be filed prior to operation of such system and that subsequent information regarding the system be provided on a quarterly basis thereafter and whenever any material change is made to the system. Any less frequent collection of this information would impede the Commission's ability to fulfill its statutory obligations to maintain fair and orderly markets and protect investors.

7. Inconsistencies With Guidelines in 5 CFR 1320.5(d)(2)

The information collection is consistent with the general information collection guidelines imposed for public protection as set forth in 5 CFR 1320.5(d)(2).

8. Consultation Outside the Agency

Rule 19b-5 and Form PILOT were adopted after appropriate public notice and comment.

9. Payment or Gift to Respondents

Not applicable. No payments or gifts are required to be made or are made to respondents.

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<sup>10</sup> 17 CFR 240.17a-1.

<sup>11</sup> 17 CFR 240.19b-5(e)(9).

10. Assurance of Confidentiality

The information required by Rule 19b-5 is available only for examination by the Commission, other agencies of the federal government and state securities authorities. Subject to the provisions of the Freedom of Information Act (“FOIA”),<sup>12</sup> and the Commission’s rules thereunder, the Commission will not generally publish or make available information contained in any reports, summaries, analyses, letters, or memoranda arising out of, in anticipation of, or in connection with an examination or inspection of the books and records of any person or any other investigation.

11. Sensitive Questions

Not applicable. No questions of a sensitive nature are involved.

12. Estimate of Respondent Reporting Burden

The Commission estimates that the reporting burden for each SRO that files an initial report on Form PILOT prior to operating a pilot trading system would be approximately 24 hours, including 16 hours of professional legal work and 8 hours of clerical work. The Commission estimates that the related cost to an SRO to complete an initial report on Form PILOT would be \$7,387. This estimated related cost is broken down as follows:

16 hours of in-house professional legal work at \$316/hr <sup>13</sup>	\$ 5,056
8 hours of clerical work at \$52/hr <sup>14</sup>	\$ 416
printing, supplies, copying, and postage	<u>\$ 1,915</u>
	\$7,387

The Commission estimates that the reporting burden for each SRO filing a quarterly report on Form PILOT upon commencing to operate a pilot trading system would be approximately 3 hours, including 2 hours of professional legal work and 1 hour of clerical work. The Commission estimates that the related cost to an SRO to complete a quarterly report on Form PILOT would be \$923. This estimated related cost is broken down as follows:

2 hours of in-house professional legal work at \$316/hr	\$ 632
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<sup>12</sup> 5 U.S.C. 522.

<sup>13</sup> \$316/hour figure for an Attorney is from the SIFMA’s *Management & Professional Earnings in the Securities Industry 2009*, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

<sup>14</sup> \$52/hour figure for a General Clerk is from the SIFMA’s *Office Salaries in the Securities Industry 2009*, modified by Commission staff to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits, and overhead.

1 hour of clerical work at \$52/hr	\$ 52
printing, supplies, copying and postage	<u>\$ 239</u>
	\$ 923

Each respondent would file 4 quarterly reports on Form PILOT per year, for an annual reporting burden of 12 hours (4 filings at 3 hours per filing) and at a related cost of \$3,692 (4 filings at \$923 per filing).

The Commission estimates that the reporting burden for each SRO filing a notice of a material systems change on Form PILOT upon commencing to operate a pilot trading system would be approximately 3 hours, including 2 hours of professional legal work and 1 hour of clerical work. The Commission estimates that the related cost to an SRO to complete a notice of a material systems change on Form PILOT would be \$923. This estimated related cost is broken down as follows:

2 hours of in-house professional legal work at \$316/hr	\$ 632
1 hour of clerical work at \$52/hr	\$ 52
printing, supplies, copying and postage	<u>\$ 239</u>
	\$ 923

The Commission estimates that an SRO operating a pilot trading system would file 2 notices of material systems changes on Form PILOT per year, for an annual burden of 6 hours (2 filings at 3 hours per filing) and at an annual related cost of \$1,846 (2 filings at \$923 per filing).

There are currently 14 SROs which may avail themselves of the exemption provided by Rule 19b-5. The Commission anticipates receiving as many as three (3) proposals to operate pilot trading systems filed as initial reports on Form PILOT each year. The Commission has estimated that the resultant aggregate reporting burden to all respondents in a year would be 126 hours at a related total cost of \$38,775. These aggregate figures consist of (i) 72 hours for initial reports on Form PILOT (3 filings each requiring 24 hours of work) at a related cost of \$22,161 (\$7,387 per filing multiplied by 3 filings); (ii) 36 hours for quarterly reports on Form PILOT (12 filings each requiring 3 hours of work) at a related cost of \$11,076 (\$923 per filing multiplied by 12 filings); and (iii) 18 hours for notices of material systems changes on Form PILOT (6 filings each requiring 3 hours of work) at a related cost of \$5,538 (\$923 per filing multiplied by 6 filings).

For the purposes of these estimates, the Commission staff has valued related overhead at 35% of the value of legal and clerical time combined.

### 13. Estimate of Total Annualized Cost Burden

Not applicable. It is not anticipated that respondents will have to incur any capital and start-up costs, nor any additional operational or maintenance costs (other than as provided in Item 12), to comply with the collection of information.

Additionally, the Commission notes that Rule 19b-5 does not in itself impose new recordkeeping burdens on SROs, though it relies on existing requirements imposed pursuant to Rule 17a-1 under the Act.

#### 14. Estimate of Cost to the Federal Government

The Commission anticipates receiving as many as three initial reports on Form PILOT per year. The Commission staff estimates that the average annual cost to the Commission of processing the filings would be \$6,663. This aggregate figure includes the following component costs:

3 initial reports on Form PILOT per year

3 hours legal processing time at \$235/hr	\$ 705
overhead, including clerical work	<u>\$ 247</u>
	\$ 952

12 quarterly reports on Form PILOT per year

12 hours legal processing time at \$235/hr	\$ 2,820
overhead, including clerical work	<u>\$ 987</u>
	\$ 3,807

6 notices of systems changes on Form PILOT per year

6 hours legal processing time at \$235/hr	\$ 1,410
overhead, including clerical work	<u>\$ 494</u>
	\$ 1,904

As previously stated, for the purposes of our estimates the Commission staff has valued related overhead at 35% of the value of legal and clerical time combined.

The Commission notes that, after the two-year exemption provided by Rule 19b-5 from the rule-change filing requirements under Section 19(b) of the Act has expired for a given trading system operated by an SRO, the burden to the federal government will remain reduced because the Commission staff tasked with processing the subsequent proposed rule changes for such trading system will already be familiar with that system.

#### 15. Explanation of Changes in Burden

The estimates of burden under Rule 19b-5 have decreased since the prior submission. In the prior submission, the Commission anticipated receiving as many as six proposals per year from six respondents to operate pilot trading systems filed as initial reports on Form PILOT each year. The Commission estimated that each respondent would file four quarterly reports on Form PILOT per year, for a total of 24 quarterly reports from all respondents, and 2 notices of material systems changes on Form PILOT per year, for a total of 12 notices of material systems changes from all respondents.

Since the prior submission, the Commission has received no initial reports on Form PILOT. The Commission has received four Form PILOT submissions since Rule 19b-5 was adopted and

the Form PILOT process was created in 1998. Additionally, no pilot trading system is currently operating under the Rule 19b-5 exemption. Based on these facts and circumstances, at this time the Commission anticipates receiving up to three proposals to operate pilot trading systems filed as initial reports on Form PILOT each year. The Commission continues to estimate that each respondent filing an initial proposal would file four quarterly reports on Form PILOT per year, for a total of 12 quarterly reports from all respondents, and 2 notices of material systems changes on Form PILOT per year, for a total of 6 notices of material systems changes from all respondents. Based on the Commission's experience with Rule 19b-5 since its adoption, the Commission now believes that it would be reasonable to make a much lower estimate of the number of pilot trading systems that will be established by SROs over the next three-year period pursuant to Rule 19b-5. Although the Commission anticipates fewer initial filings on Form PILOT, and thus fewer overall quarterly filings and notices of material systems changes, the Commission estimates the time required to complete an initial form, quarterly report or notice of material system change to be the same. Therefore, the estimated aggregate reporting burden to all respondents in a year under Rule 19b-5 has decreased from 252 hours to 126 hours. Although the total estimated annual hour compliance burden has decreased, the estimated related cost associated with such burden has increased from \$13,030 to \$38,775 due to increases in the hourly estimated rates for professional legal work and clerical work.<sup>15</sup>

16. Information Collection Planned for Statistical Purposes

Not applicable. The information is not published for statistical use.

17. Explanation as to Why Expiration Date Will Not Be Displayed

Not applicable.

18. Exceptions to Certification

None.

**B. Collection of Information Employing Statistical Methods**

Not applicable. The collection of information does not employ statistical methods.

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<sup>15</sup> See supra notes 13 and 14.