

## **PAPERWORK REDUCTION ACT SUBMISSION**

### **Rule 602 of Regulation NMS: Dissemination of Quotations in NMS securities**

#### **Supporting Statement**

##### **A. Justification**

###### **1. Necessity of Information Collection**

Section 11A(a)(2) of the Securities Exchange Act of 1934 (“Exchange Act”) directs the Securities and Exchange Commission (“Commission”) to use its authority under the Exchange Act to facilitate the establishment of a national market system in which, among other things, brokers, dealers, and investors have access to information on securities quotations and transactions. Moreover, the Commission is authorized, under Sections 11A(c)(1)(B) and (F) of the Exchange Act, to assure the prompt, accurate and reliable distribution of quotation information and to assure the fairness and usefulness of the form and content of such information. To achieve these statutory objectives, the Commission promulgated Rule 11Ac1-1, currently designated as Rule 602 of Regulation NMS, 17 CFR 242.602.<sup>1</sup>

Rule 602 contains two related collections of information. The first collection of information is found in Rule 602(a). This third party disclosure requirement obligates each national securities exchange and national securities association to make available to quotation vendors for dissemination to the public the best bid, best offer, and aggregate quotation size for each “subject security,” as defined under the Rule. The second collection of information is found in Rule 602(b). This third party disclosure requirement obligates exchange members and over-the-counter (“OTC”) market makers that are a “responsible broker or dealer,” as defined under the Rule, to communicate to an exchange or association their best bids, best offers, and quotation sizes for subject securities.<sup>2</sup>

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<sup>1</sup> Regulation NMS redesignated the national market system rules previously adopted under Section 11A of the Exchange Act. Securities Exchange Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

<sup>2</sup> Under Rule 602(b)(5), electronic communications networks (“ECNs”) have the option of reporting to an exchange or association for public dissemination, on behalf of customers that are OTC market makers or exchange market makers, the best-priced orders and the full size for such orders entered by market makers on the ECN, to satisfy such market makers’ reporting obligation under Rule 602(b). Since this reporting requirement is an alternative method of meeting the market makers’ reporting obligation, and because it is directed to nine or fewer persons (ECNs), this collection of information is not subject to OMB review under the Paperwork Reduction Act (“PRA”).

2. Purposes of, and Consequences of Not Requiring, the Information Collection

Each of the collections is necessary to achieve the statutory objective of disseminating high-quality quotation information to the public. Brokers, dealers, other market participants, and members of the public rely on the quotation information required by Rule 602 to determine the best price and market for execution of investor orders. In the absence of these collections of information, investors may not be aware of the best bids and offers available from all significant market participants in securities. Not requiring the information would impair the opportunity for investors to have their orders executed in the best market, which is another important objective of the national market system set forth in Section 11A(a)(1)(C)(iv) of the Exchange Act.

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

Improved information technology facilitates the dissemination of quotation information in an accurate and timely fashion. Such technology enables persons subject to Rule 602 to collect the required information electronically. Thus, the Commission believes that improved technology reduces the burden imposed by these information collections.

4. Efforts to Identify Duplication

The required information is not duplicative of any other information collection.

5. Effect on Small Entities

The fourteen national securities exchanges and one national securities association obligated to report under Rule 602(a) are not small entities as defined by Commission rules. For the reporting obligations under Rule 602(b), only 20 of the 1095 exchange members are small entities. In addition, as noted in Section 12 of this submission, all OTC market makers currently comply with the Rule by providing their quotations to an exchange of which they are a member. Thus, the proportion of respondents under Rule 602(b) that are small entities is very low. In addition, an OTC market maker must have an executed volume of more than 1% of the aggregate reported volume in an exchange-traded security to trigger the quoting requirements of Rule 602(b). Small broker-dealers that are OTC market makers are likely to cross this 1% reporting threshold in a small number of NMS stocks. Accordingly, their burden of collection is likely to be significantly less than the average burden of collection for all respondents under Rule 602(b).

6. Consequences of Less Frequent Collection

The information is collected as each quotation is communicated. Accordingly, any less frequent collection would deprive the public of information on the best prices for a security and undermine the purposes of Rule 602.

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

This information collection is not conducted in a manner that is inconsistent with 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

Rule 602 was adopted by the Commission after notice and comment, including a request for comments regarding the collections of information in a separate PRA section. The Commission also has published proposed amendments to Rule 602 for public notice and comment.

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

No assurances of confidentiality are necessary because the information will be made available to the public.

11. Sensitive Questions

Not applicable. Rule 602 does not require information of a sensitive nature.

12. Estimate of Respondent Reporting Burden

The aggregate reporting burden under Rule 602 is 24,117 hours annually, which is comprised of 3,750 hours relating to Rule 602(a) and 20,367 hours relating to Rule 602(b), as explained in further detail below.

a. Rule 602(a)

For the reporting obligation under Rule 602(a), the respondents are the fourteen national securities exchanges and one national securities association.<sup>3</sup> The Commission

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<sup>3</sup> The fourteen national securities exchanges registered with the Commission under Section 6(a) of the Exchange Act are: BATS Exchange Inc.; Chicago Board Options Exchange, Incorporated; C2 Options Exchange, Incorporated; Chicago Stock Exchange, Inc.; EDGA Exchange, Inc.; EDGX Exchange, Inc.; International Securities Exchange LLC; The Nasdaq Stock Market LLC; NASDAQ OMX BX, Inc.; NASDAQ OMX PHLX, Inc.; National Stock Exchange, Inc.; New York Stock Exchange LLC; NYSE Amex, Inc.; and, NYSE

estimates that each exchange or association on average will respond (i.e., disseminate and update bids, offers, and quotation sizes to quotation vendors) approximately 49,408,510,743 times per year.<sup>4</sup> The Commission estimates that the average annual time burden for each national securities exchange or national securities association is 250 hours<sup>5</sup> which results in an annual aggregate burden for all respondents under Rule 602(a) of 3,750 hours.<sup>6</sup>

b. Rule 602(b)

For the reporting obligation under Rule 602(b), the respondents are exchange members and OTC market makers.

With respect to exchange members, the highly automated trading systems now operated by securities exchanges have transformed the nature of trading and the communication of quotations on an exchange. Exchange members that communicate a quotation on an exchange through its automated systems necessarily will also have communicated that quotation to the exchange in compliance with Rule 602(b). As a result, the communication of quotations through an exchange's electronic trading system effectively means that members currently have no reporting burden under Rule 602(b) for these quotations. While a few exchanges continue to operate manual trading floors in conjunction with their automated trading systems, the Commission believes that these exchanges have provided their floor members with automated means to communicate on the exchange any quotations that would fall within the requirements of Rule 602(b), and that such automated communication on the exchange also would comply with Rule 602(b). The manual trading floors generally are used for more specialized types of trading services, such as price improvement auctions and various types of facilitation and exposure mechanisms for large orders that do not fall within the requirements of Rule 602(b).

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Arca, Inc. The one national securities association registered with the Commission under Section 15A of the Exchange Act is the Financial Industry Regulatory Authority, Inc. (previously, the National Association of Securities Dealers, Inc.).

<sup>4</sup> The Commission derived the average number of responses per national securities exchange or national securities association as follows: 741,127,661,148 (total number of responses in 2009) / 15 (the total number of national securities exchanges and national securities associations in 2010) = 49,408,510,743 average annual number of responses per respondent under 602(a).

<sup>5</sup> The Commission derived the annual time burden for each national securities exchange or national securities association from the following: 3,750 hours (aggregate burden for all respondents in hours) / 15 (number of respondents) = 250 hours (total annual burden for each respondent in hours).

<sup>6</sup> Accordingly, the time per response under Rule 602(a) is: 49,408,510,743 annual responses per respondent / 250 annual burden hours per respondent = approximately 18.22 microseconds per response under Rule 602(a).

With respect to OTC market makers, Rule 602(b) applies to quotations that are communicated to a broker or dealer or customer otherwise than on an exchange. The Commission estimates that there currently are approximately 130 OTC market makers responsible for more than 1% of the trading volume in an exchange-traded security. All such OTC market makers comply with Rule 602(b) by providing their quotations to an exchange rather than to an association.<sup>7</sup> The Commission estimates that each OTC market maker on average will respond on average 188,000 times per year. This figure is based on a 252 trading day year. The total annual time burden for each OTC market maker is estimated to be 156.67 hours. These figures are based on an estimate of three seconds per response (i.e., the time it takes to update a quote). The annual aggregate burden for all OTC market makers is estimated to be 20,367 hours.<sup>8</sup>

13. Estimate of Total Annualized Cost Burden

Not Applicable.

14. Estimate of Cost to Federal Government

There is no estimated operation cost for the federal government associated with Rule 602.

15. Explanation of Changes in Burden

a. Rule 602(a)

No previous estimate was provided for the reporting obligations under Rule 602(a) in the Commission's last information collection submission under OMB Control Number 3235-0461. Under the PRA, the Commission is not required to submit a collection of information to OMB for review unless it applies to ten or more persons. The application of Rule 602(a) of Regulation NMS did not contain "collection of information requirements" within the meaning of the PRA because fewer than ten exchanges and associations existed. Currently, there are fourteen national securities exchanges and one national securities association. Accordingly, the Commission updated its overall burden estimate for this collection of information to account for an increase in the number of exchanges subject to Rule 602(a).

b. Rule 602(b)

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<sup>7</sup> In 2006, the Commission granted an exemption from Rule 602 that permits OTC market makers that also are exchange members to provide their best bids and offers to an exchange, without the necessity of also providing their best bids and offers to an association.

<sup>8</sup> Accordingly, the time per response under Rule 602(b) is: 188,000 annual responses per respondent / 156.67 annual burden hours per respondent = approximately 3.00 seconds per response under Rule 602(b).

In its last submission under OMB Control Number 3235-0461, the Commission estimated that there were 721 respondents under Rule 11Ac1-1(c), now designated as Rule 602(b) of Regulation NMS. The annual aggregate burden was estimated to be 120,960 hours for exchange specialists, and 84,396 hours for OTC market makers, for a total of 205,486 hours.

The Commission's previous estimates of the number of respondents and reporting burden time were based on the market structure in 1996, when the Commission adopted significant amendments to Rule 602 (then Rule 11Ac1-1) that, among other things, required an OTC market maker to publish quotations for any exchange-traded security when it is responsible for more than 1% of the aggregate trading volume for that security and to make publicly available any superior prices that the market maker privately quoted through certain ECNs.<sup>9</sup> At that time, the majority of exchange trading occurred on manual trading floors. Since 1996, technology has transformed how quotes are updated and reported. Securities exchanges now primarily operate automated systems that update and report their quotations electronically. As discussed in Section 12 of this submission, the use of exchanges' automated trading systems by exchange members effectively results in exchange members having no reporting burden under Rule 602(b). With respect to OTC market makers, the reduction in burden from previous estimates results from the reduction in the estimated number of OTC market makers that cross the 1% volume threshold. As a result of these changes, the estimated reporting burden of respondents under Rule 602(b) declined significantly to 20,367 hours. Additionally, the \$66,000 cost reported in the prior submission was reported in error.

16. Information Collection Planned for Statistical Purposes

Not applicable.

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

Not applicable.

18. Exceptions to Certification

Not applicable.

B. Collections of Information Using Statistical Methods

No statistical methods are employed in connection with the collection of information.

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<sup>9</sup> See Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290, 48293 (September 12, 1996).