

# PAPERWORK REDUCTION ACT SUBMISSION

## Rule 613

### Supporting Statement

#### A. Justification

##### 1. Necessity of Information Collection

Today's electronic, interconnected markets have created a heightened need for regulators to have efficient access to a more robust and effective cross-market order and execution tracking system. Currently, many of the national securities exchanges and FINRA have audit trail rules and systems to track information relating to orders received and executed, or otherwise handled, in their respective markets. While the information gathered from these audit trail systems aids the SRO and Commission staff in their regulatory responsibility to surveil for compliance with SRO rules and the federal securities laws and regulations, the Commission believes that existing audit trails are limited in their scope and effectiveness in varying ways. In addition, while the SRO and Commission staff also currently receives information about orders and/or trades through the EBS system, Rule 17a-25, and from equity cleared reports, the information is limited, to varying degrees, in detail and scope.

The creation and implementation of a consolidated audit trail, as proposed, would enable regulators to better fulfill their regulatory responsibilities to monitor for and investigate potentially illegal activity in the national market system for securities in a more timely fashion, whether on one market or across markets. A consolidated audit trail also would enhance the ability of the Commission in investigating and preparing market reconstructions, and in understanding the causes of unusual market activity. Further, timely pursuit of potential violations can be important in seeking to freeze and recover any profits received from illegal activity.

Rule 613 under Section 11A(a)(3)(B) of the Securities Exchange Act of 1934 would require all national securities exchanges and national securities associations to jointly submit to the Commission an NMS plan to create, implement, and maintain a consolidated audit trail that would be more comprehensive than any audit trail currently in existence. The proposed Rule would require the consolidated audit trail to capture certain information about each order for an NMS security, including the identity of the customer placing the order and the routing, modification, cancellation or execution of the order, in real time. The proposal would create a time-stamped "electronic audit trail record or report" for every order, and each market participant that touches the order would be required to report information about certain reportable events, such as routing or execution of the order.

This consolidated order audit trail could enhance the ability of the SROs to carry out their obligations to regulate their markets and their members, could aid the

Commission in fulfilling its statutory obligations to oversee SROs, monitor for the manipulation of security prices, and the use of manipulative or deceptive devices in the purchase or sale of a security, as well as to perform market reconstructions.

Proposed Rule 613 could also benefit the industry, through potential cost reductions, by eliminating the need for certain SRO and Commission rules that currently mandate the collection and provision of information, at least with respect to NMS securities. It may also benefit SROs, as well as the NMS for NMS securities, by ultimately reducing some regulatory costs, which may result in a more effective re-allocation of overall costs.

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

The exchanges and FINRA could more effectively and efficiently fulfill their statutory obligations if the SROs had direct, electronic real time access to consolidated and more detailed order and execution information across all markets. Additionally, electronic real time access to consolidated information and more detailed cross market order and execution information would aid the Commission in carrying out its own statutory obligations. Not having this order and execution information in the fashion created by the proposed Rule would hinder the Commission and SROs' efforts to most effectively monitor trading occurring across markets, to detect and investigate abuses of trading across markets, as well as to create cross-market reconstructions, especially necessary in times of market turmoil.

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

The proposed Rule would create an electronic audit trail record or report for every order, and each market participant that touches the order would be required to report information about certain reportable events, such as routing or execution of the order. The Commission believes that improvements in telecommunications and data processing technology may reduce any burdens associated with proposed Rule 613.

4. Efforts to Identify Duplication

The proposed Rule would require the collection and reporting to the central repository of some information that national securities exchanges, national securities associations, and their members already are required to collect, and under certain circumstances, report to a third party, in compliance with existing Commission and SRO requirements. The proposed Rule would, however, require exchanges, associations, and their members to report to the central repository information not required to be currently collected and reported pursuant to existing SRO audit trail rules.

The proposed Rule would require the collection and reporting on a real-time basis of some information that national securities exchanges and national securities associations already collect to operate their business, and are required to maintain in

compliance with Section 17(a) of the Exchange Act and Rule 17a-1 thereunder. For instance, the Commission believes that exchanges keep records pursuant to Section 17(a) of the Exchange Act and Rule 17a-1 thereunder in electronic form, of the receipt of all orders entered into their systems, as well as records of the routing, modification, cancellation, and execution of those orders. However, the proposed Rule would require each SRO to collect and report additional and more detailed information, and to report the information to the central repository in real time in a specified uniform format. The Commission anticipates that exchanges may need to enhance or replace their current systems to be able to comply with the proposed information collection and reporting requirements of the proposed Rule. The Commission recognizes that the extent to which a particular SRO would need to make systems changes would differ depending upon the SRO's current market structure and existing systems.

Broker-dealers are subject to record keeping and reporting requirements under Rules 17a-3 and 17a-25 under the Exchange Act. Rule 17a-3 requires that broker-dealers maintain records that would capture some of the same information required to be collected and submitted pursuant to the proposed Rule. Also, as part of the Commission's existing EBS system, pursuant to Rule 17a-25 under the Exchange Act, the Commission requires registered broker-dealers to keep records of some of the information that would be captured by proposed Rule 613.

However, data collected pursuant to Rules 17a-3 and 17a-25 is limited in scope and is provided to the Commission only upon request. The proposed Rule would require the collection of significantly more information and would require that most of the information about orders and executions be provided to the central repository on a real time basis, not merely be stored and provided upon request. Thus, the Commission preliminarily believes that while these Federal rules overlap with certain requirements of the proposed Rule, the scope and purpose of the proposed Rule is more expansive than what is currently required.

#### 5. Effect on Small Entities

Proposed Rule 613(g) would apply to all broker-dealers that are members of a national securities exchange or national securities association. Commission rules generally define a broker-dealer as a small entity for purposes of the Exchange Act and the Regulatory Flexibility Act if the broker-dealer had a total capital of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared, and it is not affiliated with any person (other than a natural person that is not a small entity).

The Commission estimates that as of December 31, 2008, there were approximately 890 Commission-registered broker-dealers that would be considered small entities for purposes of the statute. Each of these brokers-dealers, assuming that they are all members of one or more national securities exchange or FINRA, would be required to comply with the proposed Rule.

Proposed Rule 613(g)(2) would impose new reporting and record keeping requirements on small broker-dealers. While certain elements of order and execution information that such small broker-dealers would be required to collect and submit to the central repository are already required to be maintained by broker-dealers pursuant to Rules 17a-3 and 17a-25 under the Exchange Act or the SRO audit trail rules, the proposed Rule would require the collection of additional information that is not required to be collected under these rules. Further, small broker-dealers would be responsible for complying with the proposed Rule's requirements for reporting to the central repository the required order and transaction data.

The proposed Rule would require that most of the information collected be reported on a real time basis, rather than on an "as requested" basis, and that all required information be submitted in a uniform format. Accordingly, the Commission believes that even those small broker-dealers that already have systems in place for submitting order and transaction information to regulators upon request, or to comply with existing SRO audit trail rules, would need to make modifications to their existing order handling and trading systems to comply with the proposed Rule, or rely on outside vendors to provide a functionality that would provide information to the central repository.

6. Consequences of Less Frequent Collection

The information is collected as each transaction warrants and therefore there is no way to require less frequent collection without undermining the purposes of the rule.

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

The Commission discussed the necessary system and hardware changes, time and costs associated with compliance with the proposed Rule with nine market participants representing a cross-section of the industry. Additionally, before adoption, Commission rules are published for notice and comment.

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

The proposed Rule would limit the use of the consolidated data by the SROs for purposes of performing their respective regulatory and oversight responsibilities pursuant to the federal securities laws, rules, and regulations. This proposed restriction would not prevent any SRO from using the data that it individually collects and provides to the

central repository pursuant to the proposed Rule for other purposes as permitted by applicable law, rule or regulation.

Proposed Rule 613(e)(4)(i) also would require that the NMS plan include policies and procedures, including standards, to be used by the plan processor to ensure the security and confidentiality of all information submitted to, and maintained by, the central repository. The plan sponsors, and employees of the plan sponsors and central repository, would be required to agree to use appropriate safeguards to ensure the confidentiality of such data, and not to use such data for other than for surveillance regulatory purposes. The Commission is not proposing to mandate the content or format of the policies and procedures and standards that would be required. Rather, the Commission believes that the SROs themselves are in the best position to determine how best to implement this requirement.

The Commission would establish appropriate protections within the agency to help ensure the confidentiality of the records proposed to be accessible to the Commission pursuant to the proposed Rule.

11. Sensitive Questions

Potentially, the proposed Rule's requirement that a unique identifier be associated with each order, representing each customer, broker-dealer, and SRO across the markets, could be deemed sensitive despite its indirectly identifying nature. Additionally, because of the real time nature of the reporting, information about live orders will be collected and submitted to the central repository for SROs and the Commission to access. The proposed Rule requires SROs to implement policies and procedures to limit access and maintain and secure the confidential character of this information. The Commission will also implement policies and procedures to ensure the security of this information.

12. Estimate of Respondent Reporting Burden

A. National Securities Exchanges and National Securities Associations

a. Creation and Filing of NMS Plan

The Commission estimates that the average one-time initial burden of developing and filing the NMS plan would be 840 burden hours per SRO. The Commission estimates that, on average, each SRO would also incur 192 burden hours annually to ensure that the NMS plan is up to date and remains in compliance with the proposed Rule.

The Commission estimates that it would take the SROs approximately 7,080 annualized burden hours of internal legal, compliance, information technology, and business operations time to develop and file the NMS plan, and to keep the plan up to date and in compliance with the proposed Rule ([840 initial one-time burden hours amortized over three years] + [192 ongoing annual burden hours] X 15 SROs).

b. Report

The Commission estimates that it would take each SRO approximately 420 burden hours of internal legal, compliance, business operations and information technology staff time to create the report required by the proposed Rule.

The Commission estimates that it would take the SROs 2,100 annualized burden hours to create the report ([420 initial one-time burden hours amortized over 3 years] X 15 SROs).

c. Data Collection and Reporting

The Commission estimates that the initial one-time burden per SRO for development and implementation of the systems needed to capture the required information and transmit it to the central repository in a specified format in compliance with the proposed Rule would be 2,200 hours. The Commission estimates that, on average, it would take an SRO approximately 4,975 ongoing burden hours annually to ensure that the system technology is up to date and remains in compliance with the proposed Rule.

The Commission estimates that it would take the SROs 85,625 annualized burden hours to develop and implement the systems, as well as to keep the systems up to date and in compliance with the proposed Rule ([2,200 initial one-time burden hours amortized over three years] + [4,975 ongoing annual burden hours] X 15 SROs).

d. Central Repository

The Commission estimates that there would be an average initial one-time burden of 17,500 hours per SRO for the development and implementation of the systems needed to capture the required information in compliance with the proposed Rule. The Commission estimates that the burden per SRO to ensure that the system technology and functionality is up to date and remains in compliance with the proposed Rule would be 192 hours per year.

The Commission estimates that it would take the SROs 90,380 annualized burden hours for development and implementation of the systems needed to capture the required information, and to ensure that the system technology and functionality remains up to date and in compliance with the proposed Rule ([17,500 initial burden hours amortized over three years] + [192 ongoing annual burden hours] X 15 SROs).

e. Collection and retention of the NBBO and transaction reports

The initial one-time burden hour estimate for development and implementation of the systems at the central repository necessary to receive and retain the NBBO and last sale information is already included in the burden estimates for the central repository.

B. Broker-Dealer Members

The Commission believes that members that rely mostly on their own internal order routing and execution management systems would need to make changes to or replace such systems to collect and report the required order and reportable event information to the central repository as required by the proposed Rule. The Commission estimates that there are approximately 1,114 of these types of members. The Commission estimates the average initial one-time burden to develop and implement the needed systems changes to capture the required information and transmit it to the central repository in compliance with the proposed Rule for these members would be approximately 6,530 burden hours. The Commission preliminarily estimates that, on average, it would take a member of a national securities exchange or national securities association approximately 3,050 burden hours per year continued compliance with the proposed Rule.

The Commission estimates that it would take such members 5,822,506 annualized burden hours to develop and implement the needed systems changes to capture the required information and transmit it to the central repository in compliance with the proposed Rule and to ensure that the systems remain in continued compliance with the proposed Rule ( $[6,530 \text{ initial burden hours amortized over three years}] + [3,050 \text{ annual ongoing burden hours}] \times 1,114 \text{ members}$ ).

The Commission believes that other members, which could include broker-dealers defined as “small entities” for purposes of the Regulatory Flexibility Act, generally would rely on the functionality provided by third parties to electronically capture the required information and transmit it to the central repository in real time. The Commission estimates that there are approximately 3,006 of these types of members. For these members, Commission staff estimates that each, on average, would incur a one-time burden of 140 hours to incorporate this functionality. The Commission also estimates that each such member would incur a cost for compliance personnel necessary to oversee continued compliance with the proposed Rule, which would result in 64 ongoing annual burden hours per such member.

The Commission estimates that it would take such members 332,664 annualized burden hours to develop and implement the needed systems changes to capture the required information and transmit it to the central repository and to ensure that the systems remain in continued compliance with the proposed Rule ( $[140 \text{ initial burden hours amortized over three years}] + 64 \text{ annual ongoing burden hours}] \times 3,006 \text{ members}$ ).

The Commission believes that the proposed rule would apply to all 5,178<sup>1</sup> broker-dealers that are currently registered with the Commission and are members of the national securities exchanges or FINRA. In calculating the estimated costs of the proposed rule for broker-dealers, the Commission recognized that the extent to which a

<sup>1</sup> This is the number of broker-dealers filing FOCUS Reports at year-end 2008. FOCUS Reports are required to be filed by all registered broker-dealers, with a few exceptions. Excluded from this number were recently established broker-dealers that had yet to become active, or broker-dealers no longer doing business that had yet to deregister.

particular member would need to make systems changes to collect and report information to the central repository would depend on the broker-dealer's current business operations and systems. Broker-dealers also vary in size from very large firms to single-man operations. To prepare the most accurate estimate possible, the Commission based its calculations on two broad categories of broker-dealers: broker-dealers that will rely on their own internal order routing and execution management systems to collect and report the required order and execution information to the central repository<sup>2</sup>; and broker-dealers that will rely on the functionality provided by third parties to electronically capture the information and transmit it to the central repository in real time, in compliance with the proposed rule<sup>3</sup>. The Commission estimated that there are 1,114 and 3,006 such broker-dealers respectively. The Commission's estimates are based on the best data available to the Commission. The Commission notes that it possesses no hour burden information for the collection and reporting of order and execution information to the central repository for the remaining 1,058 broker-dealers, and sought to address this issue by soliciting comments on the Commission's proposed estimated hour burden on broker-dealers to comply with the proposed rule.

13. Estimate of total annualized cost burden

A. National Securities Exchanges and National Securities Associations

a. Creation and Filing of NMS Plan

Commission staff estimates that, on average, each SRO would outsource 50 hours of legal time to develop and draft the NMS plan, for an aggregate, annualized capital cost of approximately \$100,000 resulting from outsourced legal work ([50 hours @ \$400 per hour = \$20,000, amortized over three years] X 15 SROs).

b. Report

The Commission estimates that, on average, each SRO would outsource 25 hours of legal time to create the report, for a one-time capital cost of approximately \$10,000

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<sup>2</sup> This category includes members that are clearing broker-dealers that carry customer accounts; broker-dealers that accept customer monies but do no margin business; introducing brokers that clear proprietary securities transactions; ATSS registered with the Commission; other clearing firms; and registered market makers. This number was derived from annual FOCUS reports filed with the Commission for the year ending in 2008.

<sup>3</sup> This category includes introducing broker-dealers that do not clear transactions. This number excludes non-clearing firms that specialize in direct participation programs; non-clearing firms that sell insurance products; and non-clearing firms that are underwriters and retailers of mutual funds because these firms do not deal in NMS securities. This number was derived from annual FOCUS reports filed with the Commission for the year ending in 2008.



(25 hours @ \$400 per hour), and an aggregate annualized cost of \$50,000 ([\$10,000 amortized over three years] X 15 SROs).

c. Data Collection and Reporting

The Commission estimates that, on average, each exchange and association would incur approximately 40 hours of outsourced legal counsel time for the development and implementation of systems needed to capture the required information and transmit it to the central repository, and a one time software and hardware cost of \$4,542,940 each to develop and implement the necessary systems.

The Commission estimates that it would cost, on average, approximately \$1.25 million per year annually per SRO to continue to comply with the proposed requirements to provide information to the central repository, including costs to maintain the systems connectivity to the central repository and purchase any necessary hardware, software, and other materials.

Commission staff estimates that the SROs would incur an annualized cost for the development and implementation of systems needed to capture the required information and transmit it to the central repository, including the one time software and hardware costs to develop and implement the necessary systems, and costs to maintain compliance with the proposed Rule and to maintain the systems connectivity to the central repository and purchase any necessary hardware, software, and other materials of \$41,544,700 ([40 hours @ \$400 per hour = \$16,000 one-time outsourced legal cost] + [\$4,542,940 one-time software and hardware cost] amortized over three years + [\$1.25 million ongoing annual cost] X 15 SROs).

d. Central Repository

The Commission estimates that each SRO would incur software and hardware costs of approximately \$4 million per plan sponsor related to systems development.

After the central repository systems have been developed and implemented, there would be ongoing costs for operating the central repository; the cost of systems and connectivity upgrades or changes necessary to receive, consolidate, and store the reported order and execution information from SROs and their members; the cost, including storage costs, of collecting and maintaining the NBBO and transaction data in a format compatible with the order and event information collected pursuant to the proposed Rule; the cost of monitoring the required validation parameters, which would allow the central repository to automatically check the accuracy and completeness of the data submitted and reject data not conforming to these parameters consistent with the requirements of the proposed Rule; and the cost of compensating the plan processor. The Commission estimates that these ongoing costs would be approximately \$100 million total for all of the SROs.

Commission staff estimates that the SROs would incur an aggregate annualized cost for software and hardware costs related to systems development, including the



particular member would need to make systems changes to collect and report information to the central repository would depend on the broker-dealer's current business operations and systems. Broker-dealers also vary in size from very large firms to single-man operations. To prepare the most accurate estimate possible, the Commission based its calculations on two broad categories of broker-dealers: broker-dealers that will rely on their own internal order routing and execution management systems to collect and report the required order and execution information to the central repository<sup>5</sup>; and broker-dealers that will rely on the functionality provided by third parties to electronically capture the information and transmit it to the central repository in real time, in compliance with the proposed rule<sup>6</sup>. The Commission estimated that there are 1,114 and 3,006 such broker-dealers respectively. The Commission's estimates are based on the best data available to the Commission. The Commission notes that it possesses no cost estimates for the collection and reporting of order and execution information to the central repository for the remaining 1,058 broker-dealers, and sought to address this issue by soliciting comments on the Commission's proposed estimated costs to broker-dealers to comply with the proposed rule.

14. Estimate of Cost to Federal Government

There is no estimated operation costs associated with this rule.

15. Explanation of Changes in Burden

Not applicable.

16. Information Collection Planned for Statistical Purposes

Not applicable.

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

Not applicable.

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<sup>5</sup> This category includes members that are clearing broker-dealers that carry customer accounts; broker-dealers that accept customer monies but do no margin business; introducing brokers that clear proprietary securities transactions; ATSS registered with the Commission; other clearing firms; and registered market makers. This number was derived from annual FOCUS reports filed with the Commission for the year ending in 2008.

<sup>6</sup> This category includes introducing broker-dealers that do not clear transactions. This number excludes non-clearing firms that specialize in direct participation programs; non-clearing firms that sell insurance products; and non-clearing firms that are underwriters and retailers of mutual funds because these firms do not deal in NMS securities. This number was derived from annual FOCUS reports filed with the Commission for the year ending in 2008.

18. Exceptions to Certification

Not applicable.

19. Collection of Information Employing Statistical Methods

The collection of information does not employ statistical methods, nor would the implementations of such methods reduce the burden or improve the accuracy of results.