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CLIENT ALERT

SEC Proposes Sweeping Changes to Market Structure

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On December 14, 2022, the Securities and Exchange Commission (the "**SEC**") issued four proposals related to market structure (collectively, the "**Market Structure Proposals**") under the Securities Exchange Act of 1934, as amended (the "**Exchange Act**").[1] The Market Structure Proposals, if adopted, would change the manner in which a significant portion of U.S. securities trades are executed and processed and should substantially increase compliance and operational costs for broker-dealers and securities exchanges. Executive summaries of the Market Structure Proposals are provided below, followed by more detailed summaries included as appendices.

The first Market Structure Proposal, known as Regulation Best Execution ("**Reg. Best Ex**"), would establish a new regulatory framework for brokers, dealers, natural persons associated with a broker or dealer, government securities brokers, government securities dealers and municipal securities dealers (collectively, "**broker-dealers**") to meet their obligation to seek best execution of customer orders in securities. Unlike the other three proposals which focus exclusively on publicly traded equities, Reg. Best Ex would cover order handling and execution in all types of securities, including not only equities but also debt, private securities and digital assets.[2]

1 *See SEC Proposals Related to Market Structure*, SEC.gov (modified Dec. 22, 2022), *available* here. On the same day, the SEC adopted amendments to modernize Rule 10b5-1 insider trading plans and related disclosures. Our client alert discussing the amendments is *available* here.

2 Regulation Best Execution, Exchange Act Release No. 96496 (Dec. 14, 2022) [88 FR 5540 (Jan. 27, 2023)] ("**Reg. Best Ex Proposing Release**"), *available* here.

The second proposal would require orders of individual investors in stocks listed on a national securities exchange ("**NMS Stocks**") to be exposed to competition in brief, open auctions before such orders could be executed internally by any trading center (the "**Order Competition Rule**").[3] Trading centers that would be required to wait until completion of an auction to be allowed to execute would include wholesaler broker-dealers.

The third proposal would amend Regulation National Market System ("**Reg. NMS**") rules to adopt variable minimum pricing increments, or "tick sizes," for the quoting and trading of NMS Stocks regardless of trading venue, and reduce access fee caps for protected quotations in stocks. The proposed amendments would also enhance the transparency of better priced equity orders (the "**Reg. NMS Trading Amendments**").[4]

The fourth proposal would update the disclosure required for order executions in NMS Stocks (the "**Reg. NMS Disclosure Amendments**").[5] Among other changes, the proposed Reg. NMS Disclosure Amendments would expand the entities subject to Rule 605 reporting requirements to include broker-dealers that introduce or carry 100,000 or more customer accounts transacting in listed equities and entities that would operate the specified auctions proposed under the Order Competition Rule.

The Reg. NMS Trading Amendments and the Reg. NMS Disclosure Amendments received unanimous Commissioner support. The votes to propose Reg. Best Ex and the Order Competition Rule were split 3-2, with Commissioners Hester Peirce and Mark Uyeda voting against the two proposals. The comment period for the Market Structure Proposals ends March 31, 2023.

I. Reg. Best Ex

Reg. Best Ex would establish a best execution standard for broker-dealers under SEC rules[6] and require broker-dealers to establish, maintain and enforce written policies and procedures reasonably designed to comply with the new standard. The proposed rules would supplement the existing best execution rules of the Financial Industry Regulatory Authority, Inc. ("**FINRA**") and the Municipal Securities Rulemaking Board ("**MSRB**"), and broker-dealers would be required to continue to comply with the FINRA and MSRB rules in addition to the SEC rule, if the proposed rules are adopted. The Reg. Best Ex. Proposing Release noted that the proposed new standard was necessary, among other reasons, to ensure that broker-

3 Order Competition Rule, Exchange Act Release No. 96495 (Dec. 14, 2022) [88 FR 128 (Jan. 3, 2023)] ("**Order Competition Rule Proposing Release**"), *available* here.

4 Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Orders, Exchange Act Release No. 96494 (Dec. 14, 2022) [87 FR 80266 (Dec. 29, 2022)] ("**Reg. NMS Trading Amendments Proposing Release**"), *available* here.

5 Disclosure of Order Execution Information, Release No. 34-96493 (Dec.14, 2022) [88 FR 3786 (Jan. 20, 2023)] ("**Reg. NMS Disclosure Amendments Proposing Release**"), *available* here.

6 Reg. Best Ex would include Rules 1100, 1101, and 1102 under the Exchange Act.

dealers' best execution policies and procedures are robust and to focus "heightened attention" on execution of retail customer orders when execution involves conflicts of interest, such as receipt of payment for order flow.[7]

The new best execution standard proposed by the SEC would require a broker-dealer, in any transaction for or with a customer, or a customer of another broker-dealer, to use reasonable diligence to ascertain the best market for the security, and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. Reg. Best Ex would apply to transactions in all types of securities, although the Reg. Best Ex Proposing Release indicated that the SEC expected that Reg. Best Ex would not affect order handling for securities-based swaps, asset-backed securities and repurchase and reverse repurchase agreements but asked for comment on those types of transactions.[8] Proposed Rule 1100 exempts broker-dealer from compliance with the best execution standard when: (i) another broker-dealer is executing a customer order against the broker-dealer's quotation; (ii) an institutional customer, exercising independent judgment, executes its order against the broker-dealer's quotation; or (iii) the broker-dealer receives an unsolicited instruction from a customer to route that customer's order to a particular market and the order is handled in accordance with its terms.

Under the proposed Reg. Best Ex, broker-dealers would be required to establish, maintain and enforce written policies and procedures reasonably designed to comply with the best execution standard. The policies and procedures would be required to address how broker-dealers will comply with the best execution standard, including by obtaining and assessing reasonably accessible market information about price, volume, and execution quality, identifying markets that may be reasonably likely to provide the most favorable prices for customer orders, incorporating material potential liquidity sources into its order handling practices, and ensuring that it can efficiently access such liquidity sources. The policies and procedures would also be required to address routing and execution decisions in light of: (i) information with respect to the best displayed prices; (ii) opportunities for price improvement and order exposure that may result in the most favorable price; (iii) the nature of the customer orders and the trading characteristics of the underlying security; (iv) the size of the order and the likelihood of execution; (v) the accessibility of the applicable market for the security; (vi) customer instructions regarding execution in order to obtain the most favorable price; and (vii) balancing the likelihood of obtaining a better price for the order with the risk that delays could result in a worse price in determining the applicable market(s).

Broker-dealer policies and procedures would separately be required to address best execution obligations for specified "conflicted transactions" with retail customers (such as those involving payment for order flow or internalization). The policies and procedures would be required, among other things, to explain how the broker-dealer would evaluate and

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7 Reg. Best Ex Proposing Release, *supra* note 2, at 5441. By way of example, the Reg. Best Ex Proposing Release noted that there are currently 16 registered equities exchanges trading NMS Stocks, and 16 registered options exchanges, as well as, with respect to fixed income instruments, 21 corporate bond alternative trading systems ("**ATSs**"), seven municipal securities ATSs and 14 government securities ATSs, which supplement traditional over-the-counter ("**OTC**") voice trading. *Id.* at 5444.

8 *Id.* at 5483 n.264, 5542.

access a broader range of markets that might provide the most favorable price for the customer orders. Conflicted transactions are those that could create incentives for a broker-dealer to be less diligent in its search for better executions and potentially result in broker-dealers not providing best execution to customer orders.[9] The proposed requirements regarding conflicted transactions go beyond those currently in place under the FINRA and MSRB best execution rules.

Reg. Best Ex would require broker-dealers to document compliance with the best execution standard, including efforts to enforce the policies and procedures with respect to conflicted transactions and the basis and information relied on for their determinations that executions achieved with respect to such conflicted transactions would comply with the best execution standard.

Broker-dealers also would be required to document written or oral arrangements concerning payment for order flow, including the names of the parties to the arrangement and the qualitative and quantitative terms. The Reg. Best Ex Proposing Release indicated that the proposed framework would "help broker-dealers maintain consistently robust best execution practices and result in vigorous efforts by broker-dealers to achieve best execution, including in situations where broker-dealers have order handling conflicts of interest with retail customers."[10]

Under Reg. Best Ex, a broker-dealer's failure to achieve the most favorable price possible under prevailing market conditions for customer orders would be part of the consideration of whether the relevant policies and procedures are reasonably designed to achieve best execution and being appropriately enforced by the broker-dealer. The Reg. Best Ex Proposing Release noted that a broker-dealer's failure to achieve the most favorable price for customer orders would not necessarily be a violation of the new proposed best execution standard where, for example, the broker-dealer had used reasonable diligence to ascertain the best market for execution of the applicable customer orders.[11]

Broker-dealers would be required to review the execution quality of customer orders at least quarterly, compare the results with the execution quality that might have been obtained from other markets and revise their best execution policies and procedures accordingly to achieve best execution. Broker-dealers also would be required to review their best execution policies and procedures at least annually, document such reviews, and present written reports detailing the results of such reviews to their boards of directors or equivalent governing bodies.

Introducing brokers would be exempt from specified requirements of Reg. Best Ex, so long as they establish, maintain and enforce policies and procedures. At a minimum, the policies and procedures would be required to provide for regular review by the introducing broker of execution quality obtained from the executing broker, compare such execution quality

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9 *Id.* at 5441.
10 *Id.*
11 *Id.* at 5442.

with the execution quality that might have been obtained from other executing brokers, and revise its practices to achieve best execution going forward.

II. Order Competition Rule

The Order Competition Rule would prohibit a broker-dealer, wholesaler or intermediary, other than a regulated exchange or ATS that satisfies specified requirements (a "**Qualified Exchange/ATS**"),[12] from internally executing certain marketable orders of individual investors or their family members in NMS Stock unless the orders are first exposed to a "qualified auction" or executed internally at a price that is equal to or more favorable for the order than the specified limit price provided in the qualified auction. The term "individual investor" is intended to cover natural persons who trade relatively infrequently for their own or closely related accounts and in relatively small sizes. The stated purpose of the Order Competition Rule is to expose orders of individual investors to competition on an order-by-order basis and minimize transaction costs to provide the best prices for such orders.[13]

The marketable orders covered by the rule are referred to as "segmented orders." These are marketable orders in NMS Stock provided to a broker-dealer for an account of a natural person or in legal form (*e.g.*, a trust) on behalf of a natural person or group of related family members[14] in which the average daily number of trades executed in NMS Stocks was less than 40 in each of the six preceding calendar months. "Marketable orders" are composed of "market orders," *i.e.*, customer orders seeking execution at the best available price in the market, and "marketable limit orders," *i.e.*, orders specifying a price limit equal to or higher than the national best offer for the NMS Stock (the "**NBO**") if the order is an order to buy NMS Stock, or equal to or less than the national best bid (the "**NBB**"), if the order is an order to sell the NMS Stock.

The term "qualified auction" means an auction operated by a Qualified Exchange/ATS that satisfies the rule's requirements and includes the following characteristics:

- Auction messages would be disseminated through a consolidated feed of market data that is made available to all competing consolidators and self-aggregators in NMS Stock, including all data necessary to generate consolidated market data and would invite priced auction responses to trade with each segmented order, including the symbol, side, size, limit price and identity of the originating broker (unless the originator broker has certified that it has policies and procedures designed to assure that the identity will not be disclosed).

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[12] *See infra* note 44.

[13] Order Competition Rule Proposing Release, *supra* note 3, at 147.

[14] For purposes of the Order Competition Rule, a group of related family members means a group of natural persons with any of the following relationships: child, stepchild, grandchild, great grandchild, parent, stepparent, grandparent, great grandparent, domestic partner, spouse, sibling, stepbrother, stepsister, niece, nephew, aunt, uncle, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, including adoptive and foster relationships and any other natural person (other than a tenant or employee) sharing a household with any of them. Proposed Rule 600(b)(91).

- The Qualified Exchange/ATS would be required to accept auction responses for at least 100 milliseconds after an auction message is provided for dissemination and end the auction not more than 300 milliseconds after the auction message was provided for dissemination.
- Segmented orders and auction responses would be priced: (i) in an increment of no less than $0.001 for segmented orders and auction responses with prices of $1.00 or more per share; (ii) in an increment of no less than $0.0001 for segmented orders and auction responses with prices of less than $1.00 per share; or (iii) at the midpoint of the national best bid and national best offer ("**NBBO**").
- No fee could be charged for submission or execution of a segmented order or for submission of an auction response. The fee for execution of an auction response and any rebate for the submission or execution of a segmented order or for the submission or execution of an auction response would: (i) not be allowed to exceed: (A) $0.0005 per share for auction responses with prices of $1.00 or more per share, or (B) 0.05% of the auction response price per share for auction responses priced at less than $1.00 per share; and (ii) otherwise would be required to be the same rate for executed auction responses in all auctions.
- Execution requirements would: (i) provide priority to the highest priced auction responses to buy and the lowest priced auction responses to sell; (ii) prioritize customer auction responses over those for a broker or dealer at the same price; (iii) prohibit giving priority to the fastest auction response (for all responses received within the prescribed time period); (iv) prohibit favoring auction responses submitted by the broker-dealer that routed the segmented order to the auction, the originating broker for the segmented order, the Qualified Exchange/ATS operating the auction or an affiliate of any of them; (v) prioritize orders resting on a continuous order book of the Qualified Exchange/ATS at the conclusion of an auction over auction responses at a less favorable price for the segmented order; (vi) prioritize displayed orders resting on a continuous order book over auction responses at the same price; and (vii) prioritize auction responses over undisplayed orders resting on a continuous order book at the same price.

Broker-dealers originating customer orders would be required to incorporate into their written policies and procedures a methodology for identifying orders of customers that are segmented orders and identifying a segmented order as such to the routing destination. If the originating broker certifies to a Qualified Exchange/ATS conducting qualified auctions that its policies and procedures are designed to assure that the identity of the originating broker not be disclosed, directly or indirectly, to any person that potentially could participate in the qualified auction or otherwise trade with the segmented order, the applicable policies and procedures must in fact be reasonably designed to assure that the identity of the originating broker will not be disclosed to any person that potentially could participate in the qualified auction or otherwise trade with the segmented order. In cases where there are multiple originating brokers for a segmented order, they may agree among themselves in writing to delegate responsibility to one of them for identification of segmented orders, identification in connection with routing and, if applicable, maintaining procedures to protect against disclosure of the identity of the originating broker.

Under the Order Competition Rule, if a broker-dealer knows where a segmented order is to be routed for execution, it may not submit an order, or enable an order to be submitted by any other person, to the continuous order book of the applicable Qualified Exchange/ATS to which the segmented order was routed or to the continuous order book of a national securities exchange that could have priority to trade with the segmented order at the Qualified Exchange/ATS.

The Order Competition Rule requires each national securities exchange that accepts segmented orders for execution to operate a qualified auction for execution of such order unless one of the specified exceptions is met. The circumstances under which a national securities exchange would not be required to sponsor a qualified auction for segmented orders are as follows: (i) the segmented order is received and executed during a time period when no Qualified Exchange/ATS is operating a qualified auction for the segmented order; (ii) the segmented order has a market value of at least $200,000, calculated with reference to the midpoint of the NBBO when the segmented order is received by the exchange; (iii) the segmented order is executed by the exchange at a price that is equal to or more favorable than the midpoint of the NBBO when the order was received; (iv) the segmented order is a limit order with a limit price selected by the customer that is equal to or more favorable for the order than the midpoint of the NBBO when the segmented order is received by the exchange; or (v) the segmented order is received and executed by the exchange during a time period when no Qualified Exchange/ATS is operating a qualified auction for the segmented order that accepts orders that are not entirely in whole shares, and is a size, selected by the customer, that is not entirely in whole shares of an NMS Stock, in which case, the portion of such segmented order that is less than one whole share of the NMS Stock may be executed outside of a qualified auction.

There would also be limited exceptions to the requirement that segmented orders be submitted to a qualified auction prior to internalizing, such as orders with a market value of $200,000 or more or execution of the orders at a very favorable price for the individual investor (*i.e.*, the midpoint of the best displayed round lot quotations or better). Similarly, a broker-dealer would not be required to route a segmented order to a qualified auction when market conditions suggest that the auction would be unlikely to generate better prices than the NBBO. As noted by the Order Competition Rule Proposing Release, the proposed rule is designed "to give broker-dealers sufficient flexibility to obtain best execution of individual investor orders in the full range of market conditions."[15]

From the perspective of an individual investor, the Order Competition Rule would not guarantee execution in a qualified auction at a price equal to the NBBO or better, which the Order Competition Rule Proposing Release noted is also the case today. However, according to the Order Competition Rule Proposing Release, an important benefit would be that segmented orders would first be exposed to order-by-order competition and the ability to interact directly (without the

[15] *Id.* at 149.

participation of a dealer) with other investors and, in particular, institutional investors. The Order Competition Rule Proposing Release described the benefit of such interaction as follows: "When investor orders are able to interact directly at a fully competitive price without the intermediation of a wholesaler or other dealer, two investors (both the buyer and the seller) are able to benefit mutually from a single trade, thereby promoting the NMS objective that, consistent with the objectives of economically efficient execution of securities transactions and the practicability of brokers executing investors' orders in the best market, investors' orders have an opportunity to be executed without the participation of a dealer."[16] The Order Competition Rule Proposing Release did not explain the mechanics of how institutional investors were expected to interact with segmented orders in the qualified auctions.

III. Reg. NMS Trading Amendments - Tick Sizes, Access Fees & Market Data

The Reg. NMS Trading Amendments propose changes to Reg. NMS in recognition of the "vastly different" market structure and technology available today compared to that in effect when Reg. NMS was adopted in 2005.[17] Although the SEC amended Reg. NMS in 2020 to expand the content of NMS market data to incorporate data from across the various decentralized markets, thereby providing greater transparency for investors into price quotations, the Reg. NMS Trading Amendments Proposing Release noted that other aspects of Reg. NMS still need to be updated to, among other things, ensure that investors have access to the best priced quotations available in the national market system and similarly ensure that such prices are determined by competitive market forces.[18] The proposal includes four amendments to Reg. NMS relating solely to trading in NMS Stocks. First, the proposal would reduce the minimum pricing increments for certain NMS Stocks across all trading venues. Second, the proposal would reduce access fees for execution of orders against a "protected quotation" (as defined below) or a quotation that is the NBBO in an NMS Stock commensurate with the reduction in minimum pricing increments. Third, the proposal would require exchange fees and rebates to be determinable at the time of execution. Fourth, the proposal would require publication of prices for best odd-lot orders to buy and best odd-lot orders to sell across market centers through a consolidated feed. A protected quotation is defined in Reg. NMS as a "protected bid or protected offer," which means a quotation in an NMS Stock that is: (i) displayed by an automated trading center; (ii) disseminated under an effective national market system plan; and (iii) an automated quotation that is the best bid or best offer of a national securities exchange, the best bid or best offer of the Nasdaq Stock Market, Inc., or the best bid or best offer of a national securities association."[19]

Under the Reg. NMS Trading Amendments, minimum pricing increments would be established for quotations, orders, indications of interest ("**IOI**") and trades in NMS Stocks that would be applicable to exchanges, national securities associations, ATSs, vendors and broker-dealers. Quotations, orders, IOIs and trades priced at, or greater than, $1.00 per share, unless the quotation, order, IOI or trade fell within designated exceptions, would be required to be no smaller than

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16 *Id.* at 148.

17 Reg. NMS Trading Amendments Proposing Release, *supra* note 4, at 80267.

18 *Id.*

19 *See id.* at 80269 n.29 (citing 17 CFR 242.600(b)(70) and (71)).

a specified increment, which would decrease depending upon the "Time Weighted Average Quoted Spread" for the particular NMS Stock during a specified "Evaluation Period," as set forth in the table below. For bids, offers, orders or IOIs of an NMS Stock priced below $1.00 per share, unless an exception applied, such bids, offers, orders or IOIs would be required to be priced in increments no smaller than $0.0001.

Minimum Pricing Increment	If the Time Weighted Average Quoted Spread for the NMS Stock during the Evaluation Period was:
$0.001	Equal to or less than $0.008
$0.002	Greater than $0.008 but less than or equal to $0.016
$0.005	Greater than $0.016 but less than or equal to $0.04
$0.01	Greater than $0.04

The primary listing exchange would measure and calculate the Time Weighted Average Quoted Spread for an NMS Stock and determine the applicable minimum pricing increment. The Time Weighted Average Quoted Spread is defined as the average dollar value difference between the NBB and the NBO during regular trading hours where each instance of a unique NBB and NBO is weighted by the length of time that the quote prevailed as the NBB or NBO. The Evaluation Period would be the last month of each calendar quarter during which the primary listing exchange measures the Time Weighted Average Quoted Spread of an NMS Stock that is priced equal to or greater than $1.00 per share to determine the applicable minimum pricing increment.

The Reg. NMS Trading Amendments would exclude orders that execute at, but are not explicitly priced at, the midpoint between the NBB and the NBO or the midpoint between the best protected bid and the best protected offer. The Reg. NMS Trading Amendments also would exclude orders that execute at a price that was not based, directly or indirectly, on the quoted price of an NMS Stock at the time of execution and orders for which the material terms were not reasonably determinable at the time the commitment to execute the order was made. In addition, the Reg. NMS Trading Amendments would provide the SEC with authority to exempt any person, security, quotation or order or any class or classes or persons, securities, quotations or orders, if the SEC determines that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors.

The Reg. NMS Trading Amendments Proposing Release suggested that requiring orders in NMS Stocks to be executed in the uniform minimum pricing increment sizes proposed for all trading centers would "enhance competition among trading centers by ensuring that all trading centers would be able to compete in the same price increment" and would "preserve most meaningful price improvement opportunities and potentially benefit the market as increased competition for orders, and between market participants, could promote innovation."[20]

The SEC also proposed to reduce, based on specified limits, the access fee caps that a "trading center" may charge for execution of an order against a protected quotation of the trading center or against any other quotation of the trading center that is the best bid or best offer of a national securities exchange or the best bid or best offer of a national securities association in an NMS Stock. As defined in Reg. NMS, a "trading center" is a national securities exchange or a national securities association that operates a self-regulatory trading facility, an alternative trading system, an exchange market maker, an OTC market maker or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent.[21]

The specified limits proposed are as follows: (i) if the price of a protected quotation or other quotation is $1.00 or more, the fees may not exceed or accumulate to more than $0.0005 per share for an NMS Stock that has a minimum pricing increment of $0.001 and $0.001 per share for an NMS Stock that has a minimum pricing increment greater than $0.001 per share; (ii) if the price of a protected quotation or other quotation is less than $1.00, the fees may not exceed or accumulate to more than 0.05% of the quotation price per share for the NMS Stock. In addition, the Reg. NMS Trading Amendments would prohibit a national securities exchange from imposing or permitting to be imposed any fee, rebate or other remuneration for the execution of an order in an NMS Stock if such fee, rebate or remuneration cannot be determined at the time of execution. The Reg. NMS Trading Amendments Proposing Release described the proposed fee caps as consistent with current market practices.[22]

In connection with the proposal to limit fees that can be charged for access to protected quotations, the Reg. NMS Trading Amendments Proposing Release noted that since adoption of Reg. NMS in 2005, the national securities exchanges have adopted complex fee schedules that generally have sought to reward market participants for submitting a minimum level of liquidity.[23] Because fees are often calculated after trading has occurred, based on volume in a given month, market participants do not know the fee levels at the time of execution and, thus, are not able to calculate the all-time cost of their trades. The Reg. NMS Trading Amendments would address this lack of transparency by requiring that all fees be fixed and disclosed at the time of execution.

Finally, the Reg. NMS Trading Amendments propose to accelerate changes to published data regarding NMS Stocks adopted in 2020. The proposal would also require publication of all prices better than the NBBO for odd-lots identification of the consolidated best odd-lot order. As a result, market participants would be able to identify the best priced odd-lot

[20] *Id.* at 80269.
[21] *Id.* at 80269 n.30 (citing 17 CFR 242.600(b)(95)).
[22] *Id.* at 80270.
[23] *Id.* at 80269.

orders and have additional information available to them to make their execution decisions.[24] If adopted, exclusive consolidated securities information processors ("**SIPs**"), which currently disseminate quotation information regarding NMS Stocks, would be required to disseminate the odd-lot information until the decentralized model for consolidation and dissemination of NMS Stock data, adopted as part of the SEC's 2020 amendments to Reg. NMS, is implemented. Under the decentralized model, "competing consolidators" would, in time, replace the exclusive SIPs that currently collect, consolidate and disseminate the data.[25]

IV. Disclosure of Order Execution Information

The Reg. NMS Disclosure Amendments would expand the disclosure requirements applicable to "market centers" for "covered orders" in NMS Stocks to include broker-dealers that introduce or carry 100,000 or more customer accounts ("**larger broker-dealers**") and entities that operate "qualified auctions," as described in the proposed Order Competition Rule.[26] The purpose of the proposed expansion is to enable investors to compare and evaluate execution quality across a greater number of execution platforms. The term "market center" is currently defined in Reg. NMS to include national securities exchanges, ATSs, exchange market makers, OTC market makers, and national securities associations. The definition was intended to encompass entities that hold themselves out as willing to accept and execute orders in NMS Stock. In explaining why the expansion was warranted, the SEC noted that broker-dealers generally do not fall within the definition of "market center" when routing customer orders externally, rather than executing customer orders internally, and, as a result, are not currently required to prepare Rule 605 reports. By making these broker-dealers subject to reporting requirements, the Reg. NMS Disclosure Amendments Proposing Release noted that customers will be able to use Rule 606 reports to identify the market centers to which the broker-dealers route their orders, and then access those market centers' Rule 605 reports to review the execution quality that the market centers provide.[27]

The Reg. NMS Disclosure Amendments also would: (i) expand the definition of "covered order" to include certain orders submitted outside of regular trading hours, certain orders submitted with stop prices, and non-exempt short sale orders; (ii) modify the existing order size categories to base them on round lots rather than number of shares and include additional order size categories for fractional share, odd-lot, and larger-sized orders; and (iii) create a new order type

[24] *Id.* at 80270.

[25] As noted above, the 2020 amendments have not been implemented. As a result, NMS Stock data is currently disseminated by the exclusive SIPs only and includes, for each NMS stock, the price, size, and exchange of each last sale, each exchange's current highest bid and lowest offer and the shares available at those prices, the NBBO, odd-lot transaction information, and certain regulatory and administrative data. Information on NMS Stock quotations is provided in round lots, based on the exchange rule definitions, which for most NMS Stocks is 100 shares. Information about odd-lot orders is available on individual exchange proprietary data feeds but not on a consolidated basis, and market participants interested in quotation data for individual odd-lot orders must purchase the proprietary feeds. *See id.* at 80294.

[26] In 2000, the SEC first adopted disclosure requirements for market centers as Rule 11Ac1-5 under the Exchange Act. The rule was later re-designated as Rule 605. In conjunction with the adoption of Rule 11Ac1-5, the SEC adopted Rule 11Ac1-6, which was later re-designated as Rule 606, which requires broker-dealers to disclose the identity of the "market centers" to which they route orders in NMS Stocks on behalf of customers. Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3788.

[27] *Id.* at 3786, 3792.

category for marketable immediate-or-cancel orders (“**marketable IOCs**”) and replace three existing categories of non-marketable order types with three new categories of order types (beyond-the-midpoint limit orders, executable non-marketable limit orders, and executable orders with stop prices). The Reg. NMS Disclosure Amendments would apply reporting requirements to non-marketable orders if they become “executable” during regular trading hours.

The Reg. NMS Disclosure Amendments would modify the content of Rule 605 reports by requiring them to include:

- Average time to execution, median time to execution, and 99th percentile time to execution statistics, each as measured in increments of a millisecond or finer, in lieu of current time-to-execution reporting categories.
- Realized spread statistics, calculated after 15 seconds and one minute.
- (i) average effective price over quoted spread (a percentage-based metric that represents how much price improvement an order received); (ii) percentage effective and realized spread statistics, a size improvement benchmark that could be used to calculate whether orders received an execution of more than the displayed size at the quote; (iii) specified statistical measures for non-marketable orders; and (iv) price improvement statistics for market and marketable orders showing price improvement relative to the best available price in the market, including for odd-lots.

Finally, the Reg. NMS Disclosure Amendments would require all entities subject to the rule to make a summary report available that would be formatted in the most recent versions of the XML and PDF formats as published on the SEC website.

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A more detailed summary of the proposals is included in the attached Appendices.

Appendix I
Reg. Best Ex

Reg. Best Ex would establish a best execution standard for broker-dealers, which would supplement existing FINRA and MSRB best execution rules. The proposed new SEC rules would require broker-dealers to:

- Establish, maintain and enforce written policies and procedures reasonably designed to comply with the SEC's best execution standard;
- Address in their policies and procedures how they will comply with the new standard, including, without limitation, for "conflicted transactions" with retail customers, such as those for which the broker-dealers receive payment for order flow or internalize orders;
- Document compliance with the best execution standard and the basis for their determinations regarding how best execution is achieved, including for conflicted transactions;
- Review the execution quality of customer orders at least quarterly, compare execution with the execution quality that might have been obtained from other markets and revise their best execution policies and procedures to improve execution quality going forward, accordingly; and
- Review and assess the design and overall effectiveness of its best execution policies and procedures on at least an annual basis and document such review and assessment in an annual report provided to the broker-dealer's board of directors (or equivalent governing body).[28]

I. The Best Execution Standard

Proposed Rule 1100 of Reg. Best Ex would require a broker-dealer, or a natural person who is an associated person of a broker-dealer, in any transaction for or with a customer, or a customer of another broker-dealer, to use reasonable diligence to ascertain the best market for the security, and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. Consistent with prior statements, the Reg. Best Ex Proposing Release noted that, although price is a critical element of best execution, the following "non-exhaustive" list of factors is also important to the analysis: the size of the order, speed of execution, clearing costs, the trading characteristics of the security involved, the availability of accurate information affecting choices as to the most favorable market center for execution, the availability of technological aids to process the information and the cost and difficulty associated with achieving execution in a particular market center.[29] This standard would apply to securities transactions for or with a broker-dealer's own customers, as well as securities transactions for or with customers of another broker-

[28] *See* Reg. Best Ex Proposing Release, *supra* note 2, at 5441.
[29] *Id.* at 5443.

dealer. The standard also would apply regardless of whether the broker-dealer is transacting for or with the customer on an agency basis or in a principal capacity.

An exemption from Reg. Best Ex would be available for a broker-dealer, or an associated natural person of a broker-dealer, when: (i) the broker-dealer is quoting a price for a security where another broker-dealer routes a customer order for execution against that quote; or (ii) an institutional customer, exercising independent judgment, executes its order against the broker-dealer's quotation.[30] A third exemption would be provided for a broker-dealer, or an associated natural person of the broker-dealer, when the broker-dealer receives an unsolicited instruction from a customer to route that customer's order to a particular market for execution, and the broker-dealer processes that customer's order promptly and in accordance with the terms of the order.[31]

II. Best Execution Policies and Procedures

Proposed Rule 1101(a) of Reg. Best Ex would require a broker-dealer that effects any transaction for or with a customer or a customer of another broker-dealer to establish, maintain and enforce written policies and procedures reasonably designed to comply with the best execution standard.[32] Unlike the current FINRA and MSRB rules, Proposed Reg. Best Ex would require broker-dealers' best execution policies and procedures to include specific elements, which are discussed below.

Framework for Compliance with the Best Execution Standard. Proposed Rule 1101(a)(1) would require a broker-dealer's best execution policies and procedures to address how it will comply with the proposed standard by: (i) obtaining and assessing reasonably accessible information about the execution markets, including information about price, volume and execution quality; (ii) identifying markets that may be reasonably likely to provide material potential liquidity sources for the particular securities; and (iii) incorporating material potential liquidity sources into its order handling practices and ensuring that it can efficiently access each such material potential liquidity source.[33] The Reg. Best Ex Proposing Release

30 *See* Proposed Rule 1100(a)-(b); The Reg. Best Ex Proposing Release noted that the first exemption would be consistent with existing exemptions in FINRA Rule 5310.04 and MSRB Rule G-18.05, while the second exemption would be new. *See* Reg. Best Ex Proposing Release, *supra* note 2, at 5452 n.114.

31 *See* Proposed Rule 1100(c). For purposes of Reg. Best Ex, "market" could include broker-dealers, exchange markets, markets other than exchange markets and any other ventures that emerge as markets evolve. The term also could encompass the wide range of mechanisms operated by any given market that a broker-dealer may use to transact for or with customers. *See* Reg. Best Ex Proposing Release, *supra* note 2, at 5452. This exception is consistent with interpretation .08 under FINRA Rule 5310, which provides that a member is not required to make a best execution determination beyond a customer's specific instruction when the member receives an unsolicited instruction from the customer to route that customer's order to a particular market for execution. The FINRA interpretation also requires that the broker-dealer process the customer's order promptly and in accordance with the terms of the order.

32 *See* Reg. Best Ex Proposing Release, *supra* note 2, at 5454. Currently, FINRA and MSRB rules require broker-dealers to have policies and procedures regarding best execution. *See* FINRA Rule 3110; MSRB Rule G-28. *See also* Reg. Best Ex Proposing Release, *supra* note 2, at 5455.

33 The Reg. Best Ex Proposing Release noted that interposing a third party between the broker-dealer and the material potential liquidity source would not be consistent with the concept of "efficient access" if the broker-dealer could access the market directly but chose instead to access the market indirectly resulting in a worse execution for the customer. Reg. Best Ex Proposing Release, *supra* note 2, at 5458.

expressly noted that, in the NMS Stock market, retail broker-dealers needed to consider whether markets other than off-exchange dealers, known as "wholesalers" (to which more than 90% of retail customers' marketable orders are currently routed) would provide better execution for customer orders.

While Reg. Best Ex does not provide an exhaustive list of the markets that might be considered material potential liquidity sources, or the potential sources of reasonably accessible information for different types of securities, the Reg. Best Ex Proposing Release noted that, in the NMS Stock market, material potential liquidity sources could include exchanges, ATSs and broker-dealers including market makers and wholesalers and in the OTC equities market, a broker-dealer should consider whether ATSs, wholesalers and other OTC market makers may be potential material liquidity sources. With respect to the options market, the Reg. Best Ex Proposing Release indicated that material potential liquidity sources could include the options exchanges and the range of trading protocols and auction mechanisms made available by the options exchanges. For fixed income securities, the Reg. Best Ex Proposing Release indicated that material potential liquidity sources could include ATS and non-ATS electronic trading systems, RFQ systems and other auction mechanisms as well as interdealer brokers and other broker-dealers willing to be a counterparty upon request.[34]

Best Market Determination. Proposed Rule 1101(a)(2) would require a broker-dealer's best execution policies and procedures to address how it will determine the best market and make routing or execution decisions for customer orders that it receives by: (i) assessing reasonably accessible and timely information with respect to the best displayed prices, opportunities for price improvement, including midpoint executions, and order exposure opportunities that may result in the most favorable price; (ii) assessing the attributes of customer orders and considering the trading characteristics of the security, the size of the order, the likelihood of execution, the accessibility of the market and any customer instructions in selecting the market most likely to provide the most favorable price; and (iii) in determining the number and sequencing of markets to be assessed, reasonably balancing the likelihood of obtaining better prices with the risk that delay could result in worse prices.[35] These policy and procedures requirements also would apply to wholesalers, clearing firms and firms that internalize customer orders.[36]

III. Policies and Procedures and Documentation for Conflicted Transactions

[34] *Id.* at 5458.

[35] *Id.* at 5459. While FINRA and MSRB rules also identify price information as relevant when ascertaining the best market for a security, the Reg. Best Ex Proposing Release noted that FINRA and MSRB rules do not require a broker-dealer's policies and procedures specifically to address the elements that are relevant to its best market determinations. *See* FINRA Rule 5310(a)(1); MSRB Rule G-18(a).

[36] Reg. Best Ex Proposing Release, *supra* note 2, at 5451 (noting that "the proposed best execution standard would apply to broker-dealers that internalize their customers' orders, as well as to wholesalers or clearing firms that trade as principal with the customer orders routed to them from other broker-dealers") and 5445 n.56 (noting as well that "wholesalers owe a duty of best execution to the customers of retail broker-dealers under FINRA Rule 5310.").

Proposed Rule 1101(b) of Reg. Best Ex would require a broker-dealer's best execution policies and procedures to address additional considerations with respect to "conflicted transactions"[37] and would require broker-dealers to document how it complies with the proposed best execution standard in connection with conflicted transactions. Broker-dealers would also be required to document all arrangements concerning payment for order flow.[38]

Reg. Best Ex would define a "conflicted transaction" as any transaction for or with a retail customer where a broker-dealer: (i) executes an order as principal, including riskless principal; (ii) routes an order to, or receives an order from, an affiliate for execution; or (iii) provides or receives payment for order flow, as defined in Rule 10b-10(d)(8) under the Exchange Act.[39] The additional requirements would apply to conflicted "transactions for or with a retail customer," which would be defined as any transaction for or with the account of a natural person or held in legal form on behalf of a natural person or group of related family members. The Reg. Best Ex Proposing Release noted that the focus on natural persons in the proposed definition of "retail customer" would be consistent with that in Regulation BI, the description of "retail" orders under exchange rules and FINRA's trade reporting rules. The SEC indicated that this consistency should mitigate compliance costs.[40]

Policies and Procedures for Conflicted Transactions. With respect to conflicted transactions, Proposed Rules 1101(b)(1) and (2) would require a broker-dealer's best execution policies and procedures to address: (i) how the broker-dealer will obtain and assess information beyond that required by Proposed Rule 1101(a)(1), including information about price, volume and execution quality, in identifying a broader range of markets beyond those identified as material potential liquidity sources; and (ii) how the broker-dealer will evaluate a broader range of markets, beyond those identified as material potential liquidity sources, that might provide the most favorable price for customer orders, including a broader range of order exposure opportunities and markets that may be smaller or less accessible. According to the Reg. Best Ex Proposing Release, this requirement is not designed to eliminate order handling conflicts of interest and would not ban conflicted transactions.[41]

Documentation for Conflicted Transactions. Proposed Rule 1101(b)(3) would require a broker-dealer to document its compliance with the best execution standard for conflicted transactions, including all efforts taken to enforce its policies and procedures for conflicted transactions and the basis and information relied on by the broker-dealer for its determination that such conflicted transactions would comply with the best execution standard. A broker-dealer would need to document all efforts taken to enforce its policies and procedures for conflicted transactions and demonstrate the

[37] *See* Proposed Rule 1101(b). *See* Reg. Best Ex Proposing Release, *supra* note 2, at 5464.
[38] *See* Proposed Rule 1101(b)(3). *See* Reg. Best Ex Proposing Release, *supra* note 2, at 5464.
[39] *See* Proposed Rule 1101(b). *See* Reg. Best Ex Proposing Release, *supra* note 2, at 5465. The term "affiliate" would be defined as, with respect to a specified person, any person that, directly or indirectly, controls, is under common control with, or is controlled by, the specified person. "Control" would be defined as the power, directly or indirectly, to direct the management or policies of the broker-dealer whether through ownership of securities by contract or otherwise. *See* Proposed Rule 1101(b)(4)(iii).
[40] Reg. Best Ex Proposing Release, *supra* note 2, at 5464–65.
[41] *Id.* at 5467.

basis and information relied on for its determination that conflicted transactions executed by it would comply with the SEC's best execution standard. A broker-dealer also would be required to document any arrangement, whether written or oral, concerning payment for order flow, including but not limited to the parties to the arrangement, all qualitative and quantitative terms concerning the arrangement and the date and terms of any changes to the arrangement.

IV. Regular Review of Execution Quality

Proposed Rule 1101(c) of Reg. Best Ex would require a broker-dealer, no less frequently than quarterly, to review the execution quality of its transactions for or with its customers or customers of another broker-dealer, and to analyze how such execution quality compares with the execution quality the broker-dealer might have obtained from other markets.[42] In the event that review showed that the broker-dealer might have achieved better execution by routing to a different market, the regulation would require the broker-dealer to revise its best execution policies and procedures to change its routing processes going forward. A broker-dealer would be required to document the results of this review.

V. Introducing Brokers

Proposed Rule 1101(d) of Reg. Best Ex would permit a broker-dealer that qualifies as an introducing broker to rely on its executing broker to comply with Proposed Rules 1101(a) (*i.e.*, incorporating into the firm's policies and procedures how it will comply with the best execution standard), (b) (*i.e.*, addressing in the policies and procedures, in connection with "conflicted transactions," how to obtain and assess information regarding a broader range of markets, evaluating a broader range of markets that might provide the most favorable price for customer orders and documenting compliance with the best execution standard for conflicted transactions) and (c) (*i.e.*, conducting quarterly reviews of execution quality), subject to certain review requirements. This exemption would apply to a narrower group of broker-dealers than under current FINRA and MSRB rules.

Definition of Introducing and Executing Broker. An "introducing broker" would be defined as a broker-dealer that: (i) does not carry customer accounts and does not hold customer funds or securities; (ii) has entered into an arrangement with an unaffiliated broker-dealer that has agreed to handle and execute on an agency basis all of the introducing broker's customer orders ("**executing broker**"); and (iii) has not accepted any monetary payment, service, property, or other benefit that results in remuneration, compensation or consideration from the executing broker in return for the routing or the introducing broker's customer orders to the executing broker. Two principal trading scenarios would be considered to be orders handled on an agency basis solely for the purposes of the second condition: fractional share trading in NMS Stocks and riskless principal trading in corporate and municipal bonds and government securities.[43]

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[42] *Id.* at 5472. The standard effectively requires broker-dealers to consider execution quality at trading venues it does not currently use.

[43] For purposes of Proposed Rule 1101(d)(2), riskless principal would be defined under Rule 1101(b)(4)(ii). A transaction would be riskless principal if, after having received an order to buy from the introducing broker on behalf of its customer, the executing broker purchased the security from another

Review of Executing Broker's Execution Quality. The availability of the introducing broker exemption would be conditioned on an introducing broker's establishing, maintaining and enforcing policies and procedures that require the introducing broker to regularly review the execution quality obtained, compare it with the execution quality it might have obtained from other executing brokers and revise its order handling practices accordingly to improve execution quality. The introducing broker also would be required to document the results of this review. The exemption further would require an introducing broker's policies and procedures to address the ways in which the introducing broker would revise its order handling practices if a change is warranted.

VI. Annual Report

Proposed Rule 1102 of Reg. Best Ex would require a broker-dealer that effects any transaction for or with a customer or a customer of another broker-dealer to, no less frequently than annually, review and assess the design and overall effectiveness of its best execution policies and procedures, including its order handling practices. The review and assessment would be required to be conducted in accordance with written procedures and would be required to be documented. The broker-dealer would be required to prepare a written report detailing the results of such review and assessment, including a description of all deficiencies found and any plan to address such deficiencies. This report would be required to be presented to the board of directors (or equivalent governing body) of the broker-dealer. This annual review requirement would be more extensive than the regular (*i.e.*, quarterly) review that would also be required.

VII. Related Recordkeeping Requirements under Rule 17a-4

In connection with the proposal of Reg. Best Ex, the SEC proposed new recordkeeping requirements for broker-dealers relating to rule obligations. Broker-dealers would be required to make or keep the following records:

- Policies and procedures under Proposed Rules 1101(a), (b) and (d) and Rule 1102;
- Documentation of compliance with the best execution standard for conflicted transactions under Proposed Rule 1101(b);
- Documentation of payment for order flow arrangement under Proposed Rule 1101(b);
- Documentation of the results of the regular review of execution quality under Proposed Rule 1101(c);
- Documentation of the results of the regular review of execution quality by introducing brokers under Proposed Rule 1101(d);

person to offset a contemporaneous sale to such introducing broker on behalf of a customer or, after having received an order to sell, the executing broker sold the security to another person to offset a contemporaneous purchase from such introducing broker on behalf of its customer. *Id.* at 5476.

- Documentation of the annual review under Proposed Rule 1102; and
- Annual reports under Proposed Rule 1102.

Rule 17a-4(e)(7) under the Exchange Act, relating to recordkeeping, would apply to the policies and procedures required by Reg. Best Ex. The SEC proposed to amend Rule 17a-4 to require broker-dealers to preserve all other records made pursuant to Proposed Rules 1101 and 1102 for a period of not less than three years, the first two years in a readily accessible place.

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Appendix II
Order Competition Rule

The Order Competition Rule—Proposed Rule 615 under Reg. NMS—would prohibit a broker-dealer, wholesaler or intermediary other than a Qualified Exchange/ATS,[44] from internally executing "segmented orders" of individual investors or their family members in NMS Stock unless the orders are first exposed to competition in a "qualified auction" or are executed internally at a price that is equal to or more favorable for the order than the specified limit price provided in the qualified auction.[45] There would be limited exceptions to this general prohibition, including an exception for segmented orders received and executed when no qualified auction was being operated for such orders and an exception for segmented orders having market values of $200,000 or more. The stated purpose of the Order Competition Rule is to expose orders of individual investors to competition to provide the best prices on an order-by-order basis and minimize transaction costs incurred for marketable orders of such individual investors.[46]

I. Order Competition Requirement

The proposal would prohibit a broker-dealer, wholesaler, or intermediary other than a Qualified Exchange/ATS (together, "**restricted competition trading centers**") from executing a segmented order internally until after the restricted competition trading center has exposed the order to competition at a specified limit price in a qualified auction operated by an "open competition trading center," *i.e.*, a Qualified Exchange/ATS.[47] The Order Competition Rule would prohibit all open competition trading centers from operating a system, other than a qualified auction, that is limited, in whole or in

[44] The Order Competition Rule would define Qualified Exchange/ATSs to include:

(i) a national securities exchange that operates an automated trading facility as a self-regulatory organization and displays automated quotations in consolidated market data disseminated in accordance with Reg. NMS, provides transaction reporting identifying the exchange as the execution venue through the consolidated market data, during at least four of the preceding six months had an average daily share volume of 1% or more of the aggregate average daily share volume for NMS Stocks as reported by an effective transaction reporting plan, and operates pursuant to rules that provide for compliance with the Order Competition Rule's requirements for qualified auctions; and

(ii) an ATS trading NMS Stocks that displays quotations through a self-regulation organization display-only facility in compliance with Reg. NMS, operates as an automated trading center and displays automated quotations that are disseminated in consolidated market data pursuant to Reg. NMS, provides transaction reports identifying the ATS as the venue of execution disseminated in the consolidated market data, permits any registered broker-dealer not subject to statutory disqualification or that fails to meet prescribed standards of financial responsibility or operational capability to become a subscriber, provides equal access among subscribers to qualified auctions and the continuous order book, during at least four of the preceding six months had an average daily share volume of 1.0% or more of the aggregate average daily share volume for NMS Stocks as reported by an effective transaction reporting plan, and operates pursuant to an effective Form ATS-N that evidences compliance with the Order Competition Rule's requirements for qualified auctions.

See Proposed Rule 600(b)(64).

[45] Order Competition Rule Proposing Release, *supra* note 3, at 129.

[46] *Id.* at 147.

[47] *Id.* at 159.

part, to the execution of segmented orders, unless any segmented order executed through such system qualifies for the exceptions specified in the proposed rule. [48]The proposed rule does not describe how the specified limit price to but used in a qualified auction must be set. However, the SEC indicated that the limit price would need to be consistent with the best execution responsibilities of the broker-dealer and the terms of the order as set by the customer.

II. Definition of a Segmented Order

"Segmented orders" are orders for NMS Stock for an account: (i) of a natural person or an account held in legal form on behalf of a natural person or a group of related family members; and (ii) in which the average daily number of trades executed in NMS Stock was less than 40 in each of the six preceding calendar months.[49] The proposed definition of segmented order does not have a size limitation or limit price component and would encompass orders of all sizes, including odd-lot orders with a size of less than one round lot.[50] For segmented orders that are limit orders, compliance with the order competition requirement would depend on the relation of the segmented order's limit price to the NBBO at the time it was received by the restricted competition trading center. All segmented orders that are "market orders" would be subject to the order competition requirement prior to execution.[51] The SEC noted that a key source of trading costs for individual investors are the spreads they pay when using marketable orders,[52] which the proposed rule is designed to reduce.[53]

III. Exceptions to the Auction Requirement

The proposed Order Competition Rule would provide exceptions to the order competition requirements for the following types of segmented orders:

- Segmented orders received and executed when no qualified auction was being operated for such orders (*e.g.*, the order was sent during an off-trading hour when no auction was live);

[48] *Id.* at 161–62.
[49] *Id.* at 149–50.
[50] *Id.* at 150.
[51] *Id.*
[52] *Id.* at 133.
[53] The Order Competition Rule Proposing Release explains that marketable orders generally have low potential "adverse selection costs" (*i.e.*, costs reflecting the extent to which prices move against the liquidity provider in the time after a trade thus preventing capture of a spread to realize a profit). By routing orders to an exchange, the proposing release suggests that better pricing may be available for the order as a result of execution against odd-lot quotations or undisplayed non-marketable limit orders resting on the exchange's continuous order book. *See, id.* at 134. *See also id.* at 136 ("By providing an opportunity for a wide variety of liquidity providers to compete to provide the best prices for the segmented marketable orders of individual investors, Proposed Rule 615 is designed to expand the level of NBBO price improvement currently provided by wholesalers to match the low adverse selection costs of such orders.").

- Segmented orders with market values of at least $200,000;54
- Segmented orders executed at prices that are equal to or more favorable than the midpoint of the NBBO when the orders are received;
- Segmented orders with customer-selected limit prices that are equal to or more favorable than the midpoint of the NBBO when the orders are received; 55 and
- Orders for less than one share and the fractional share portions (but not the whole share portions) of segmented orders received and executed when no qualified auction was being operated for such orders.[56]

Proposed Rule 615 does not provide an exception for orders directed by a customer to a particular restricted competition trading center for execution.[57] However, the Order Competition Rule Proposing Release noted that the proposal is designed "to give broker-dealers sufficient flexibility to obtain best execution of individual investor orders in the full range of market conditions."[58]

IV. Definitions of Open Competition Trading Centers and Restricted Competition Trading Centers

The Order Competition Rule would prohibit both national securities exchanges and NMS Stock ATSs from operating a qualified auction if they do not meet the elements of the definition of an "open competition trading center."[59] An "open competition trading center" would be a national securities exchange or ATS that meets proposed requirements for transparency, access, and volume.[60] Given the differing regulatory regimes for national securities exchanges and NMS Stock ATSs, the elements of the proposed definition of open competition trading centers would vary depending on the venue.[61]

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54 While these large orders are eligible for an exception, they still would meet the definition of a "segmented order" and could be routed for execution in a qualified auction if the broker-dealer handling the order determines that such routing would promote best execution of the segmented order. *Id.* at 156.

55 These orders would generally be treated as non-marketable limit orders. A non-marketable limit order to buy has a limit price that is less than the NBO, and a non-marketable limit order to sell has a limit price that is greater than the NBB. *Id.* at 133. Rule 604 of Reg. NMS requires exchange specialists and OTC market makers to display the price and full size of customer limit orders when these orders represent buying and selling interest that is at a better price than a specialist's or OTC market maker's public quotation. *Id.* at 143. However, a subset of non-marketable limit orders, referred to as "beyond-the-midpoint non-marketable limit orders" with prices not as favorable for individual investors would not qualify the exception. *Id.* at 157.

56 Proposed Rule 615(b)(1)-(5). *See* Order Competition Rule Proposing Release, *supra* note 3, at 244.

57 *Id.* at 156–57.

58 *See id.* at 149.

59 Proposed Rule 615(d).

60 Order Competition Rule Proposing Release, *supra* note 3, at 151–56.

61 *Id.* at 151.

National Securities Exchanges. A national securities exchange would need to satisfy the following four elements to be an open competition trading center:

- The exchange would need to operate a trading facility that is an automated trading center and displays automated quotations disseminated in consolidated market data pursuant to Rule 603(b) of Reg. NMS.[62]
- The exchange would be required to provide transaction reports identifying it as the venue of execution that are disseminated in consolidated market data pursuant to Rule 603(b).
- The exchange would be required to have had an average daily share volume of 1% or more of the aggregate average daily share volume for all NMS Stock as reported by an effective transaction reporting plan during at least four of the preceding six calendar months.
- The exchange would be required to operate pursuant to its own rules providing that such exchange will comply with the proposed requirements for qualified auctions in Proposed Rule 615(c).

NMS Stock ATSs. An NMS Stock ATS would need to satisfy the following seven elements to be an open competition trading center:

- The ATS would be required to display quotations through a self-regulatory organization ("**SRO**") display-only facility in compliance with Rule 610(b) of Reg. NMS.[63]
- The ATS would be required to operate as an automated trading center and display automated quotations that are disseminated in consolidated market data pursuant to Rule 603(b) of Reg. NMS.
- The ATS would be required to identify the NMS Stock ATS as the venue of execution in transaction reports that are disseminated in consolidated market data pursuant to Rule 603(b).
- The ATS would be required to permit any registered broker-dealer to become a subscriber, except those with statutory disqualifications or financial responsibility or operational capability concerns.
- The ATS would be required to provide equal access among all subscribers of the NMS Stock ATS and the registered broker-dealer of the NMS Stock ATS to all services that are related to a qualified auction operated by the NMS Stock ATS under Proposed Rule 615(c) and to any continuous order book operated by the NMS Stock ATS.

[62] The terms "automated quotation" and "automated trading center" are defined respectively in Rule 600(b)(6) and Rule 600(b)(7) of Reg. NMS.
[63] Currently, the only such facility is the Alternative Display Facility (the "**ADF**") operated by FINRA.

- The ATS would be required to have had an average daily share volume of 1% or more of the aggregate average daily share volume for NMS Stock as reported by an effective transaction reporting plan during at least four of the preceding six calendar months.
- The ATS would be required to operate pursuant to an effective Form ATS-N that sets forth the operations of the qualified auction and compliance by the ATS with the requirements of Proposed Rule 615(c) for a qualified auction, as well as with all of the other elements of the definition of open competition trading center for NMS Stock ATSs.[64]

Restricted Competition Trading Centers. "Restricted competition trading center" would be defined as any trading center that is not an open competition trading center and is not a national securities exchange.[65] The Order Competition Rule Proposing Release noted that the definition would include certain types of broker-dealers, such as exchange market makers, OTC market makers (including wholesalers), and internalizing broker-dealers, as well as all NMS Stock ATSs currently operating (because none of these ATSs displays quotations in the ADF).[66]

V. Broker-Dealer and Originating Broker Requirements

Broker-Dealers. Broker-dealers handling customer orders would have certain duties under the Order Competition Rule.[67] First, a broker-dealer that receives an order identified as a segmented order that is not otherwise excepted would be prohibited from routing such order without identifying the order to the routing destination as a segmented order. Second, the Order Competition Rule would prohibit a broker-dealer with knowledge of where a segmented order is to be routed from submitting an order, or enabling an order to be submitted by any other person, to the continuous order book of an open competition trading center or of a national securities exchange that could have priority to trade with the segmented order at such open competition trading center or national securities exchange. The Order Competition Rule Proposing Release noted that all other existing obligations of broker-dealers for customer orders would continue to apply.[68]

Originating Brokers. The proposed term "originating brokers" would include any broker with the sole responsibility for handling a customer account, including, but not limited to, opening and monitoring the customer account and accepting and transmitting orders for the customer account.[69] The Order Competition Rule sets forth three requirements for

[64] *Id.* at 151–55.
[65] *See* Proposed Rule 600(b)(87).
[66] Order Competition Rule Proposing Release, *supra* note 6, at 157.
[67] *Id.* at 161–63.
[68] *Id.* at 163.
[69] *Id.* at 155. To the extent that multiple brokers perform different functions for a customer account (sometimes referred to as "introducing brokers," "carrying brokers," or "clearing brokers"), each such broker would be an originating broker. In cases where multiple brokers handle discrete functions for particular orders, the broker responsible for approving the opening of customer accounts (the role typical of an introducing broker) would be identified in the auction messages required to ship with an order under Proposed Rule 615(c)(1). *See id.*

originating brokers.[70] First, an originating broker would be required to establish, maintain, and enforce written policies and procedures reasonably designed to identify the orders of customers as segmented orders. Second, an originating broker would be prohibited (unless an exception applies) from routing a customer order identified as a segmented order without also identifying the order to the routing destination as a segmented order. Third, an originating broker that makes the certification referred to in Paragraph (c)(1)(iii) of Proposed Rule 615[71] would be required, consistent with its certification, to establish, maintain, and enforce written policies and procedures reasonably designed to assure that the identity of the originating broker will not be disclosed, directly or indirectly, to any person that potentially could participate in the qualified auction or otherwise trade with the segmented order. In cases where there are multiple originating brokers for a segmented order, they may agree among themselves in writing to delegate responsibility to one of them for identification of segmented orders, identification in connection with routing and, if applicable, maintaining procedures to protect against disclosure of the identity of the originating broker.

VI. Operation of a Qualified Auction

The term “qualified auction” would be defined in Proposed Rule 600(b) as an auction operated by an open competition trading center pursuant to the Order Competition Rule. As proposed, once a trade is routed for auctioning, an auction notification would have to quickly go out to all participating exchange and ATS subscribers notifying them of the auctions, via the ADF, which would disseminate that information to exclusive SIPs.[72] Bids would need to accrue, and open competition trading platforms hosting the auction would need to record those bids and quickly finalize auction results.[73] Auction responses would not be displayed until a particular auction participant won the auction, at which time the final execution price would be displayed.[74]

If the segmented order did not receive a full execution in a qualified auction for any reason, including an auction time-out, the unexecuted order, or any unexecuted part of the order, would be canceled and sent back to the routing broker-dealer, who could, as soon as reasonably possible, execute the segmented order or unexecuted part thereof, internally at a price that was equal to or better for the segmented order than the specified market limit price that arrived with the order.[75]

70 *Id.* at 162–63.

71 As discussed below, auction messages will include the identity of the originating broker for the segmented order unless the broker certifies that it has established, maintained and enforced written policies and procedures reasonably designed to assure that the identity of the originating broker will not be disclosed, directly or indirectly, to any person that potentially could participate in the qualified auction or otherwise trade with the segmented order, and the originating broker’s certification is communicated to the open competition trading center conducting the qualified auction. *See* Proposed Rule 615(c)(i) and (iii).

72 Open Competition Rule Proposing Release, *supra* note 3, at 157.

73 *See id.* at 147–48.

74 *Id.* at 158–59.

75 *Id.* at 159.

Paragraph (c) of Proposed Rule 615 sets forth a series of specific requirements for qualified auctions:

- Auction messages would be disseminated through a consolidated feed of market data that is made available to all competing consolidators and self-aggregators in NMS Stock, including all data necessary to generate consolidated market data and would invite priced auction responses to trade with each segmented order, including the symbol, side, size, limit price and identity of the originating broker (unless the originating broker has certified that it has policies and procedures designed to assure that the identity will not be disclosed).
- The Qualified Exchange/ATS would be required to accept auction responses for at least 100 milliseconds after an auction message is provided for dissemination and end the auction not more than 300 milliseconds after the auction message was provided for dissemination.
- Segmented orders and auction responses would be priced: (i) in an increment of no less than $0.001 for segmented orders and auction responses with prices of $1.00 or more per share, (ii) in an increment of no less than $0.0001 for segmented orders and auction responses with prices of less than $1.00 per share, or (iii) at the midpoint of the NBBO.
- No fee could be charged for submission or execution of a segmented order or for submission of an auction response. The fee for execution of an auction response and any rebate for the submission or execution of a segmented order or for the submission or execution of an auction response would: (A) not be allowed to exceed: (i) $0.0005 per share for auction responses with prices of $1.00 or more per share, or (ii) 0.05% of the auction response price per share for auction responses priced at less than $1.00 per share and (B) otherwise would be required to be the same rate for executed auction responses in all auctions.
- Execution requirements would: (i) provide priority to the highest priced auction responses to buy and the lowest priced auction responses to sell, (ii) prioritize customer auction responses over those for a broker or dealer at the same price, (iii) prohibit giving priority to the fastest auction response (for all responses received within the prescribed time period), (iv) prohibit favoring auction responses submitted by the broker-dealer that routed the segmented order to the auction, the originating broker for the segmented order, the Qualified Exchange/ATS operating the auction or an affiliate of any of them, (v) prioritize orders resting on a continuous order book of the Qualified Exchange/ATS at the conclusion of an auction over auction responses at a less favorable price for the segmented order, (vi) prioritize displayed orders resting on a continuous order book over auction responses at the same price, and (vii) prioritize auction responses over undisplayed orders resting on a continuous order book at the same price.

The proposed Order Competition Rule would not limit the types of broker-dealers that would be permitted to submit segmented orders for execution in qualified auctions.[76]

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[76] *Id.* at 148.

<u>Appendix III</u>
<u>Reg. NMS Trading Amendments</u>

The Reg. NMS Trading Amendments propose changes to Reg. NMS in recognition of the "vast differences" in market structure and technology today compared to those in effect when Reg. NMS was adopted in 2005.[77] Although the SEC amended Reg. NMS in 2020 to expand the content of NMS market data to incorporate data from across the various decentralized markets, thereby providing greater transparency for investors into price quotations, the Reg. NMS Trading Amendments Proposing Release notes that other aspects of Reg. NMS still need to be updated to, among other things, ensure that investors have access to the best priced quotations available in the national market system and ensure that such prices are determined by competitive market forces.[78] The proposed Reg. NMS Trading Amendments would:

- adopt variable minimum pricing increments, or "tick sizes," for the quoting and trading of NMS Stocks regardless of trading venue;
- reduce access fee caps for protected quotations;
- require exchange fees and rebates to be determinable at the time of execution; and
- accelerate the implementation of previously adopted definitions of round lot and odd-lot information and amend the definition of odd-lot information to require the identification of the best priced odd-lot orders available in the market.[79]

Although each Commissioner supported sending the proposed Reg. NMS Trading Amendments for comment, Commissioners Uyeda and Peirce questioned aspects of the proposal.[80] Commissioner Uyeda questioned whether applying tick size limits to order executions might have other unintended effects and whether reducing maximum rebates available might adversely affect liquidity, thus reducing trading across all platforms. Commissioner Peirce questioned "why variety in the offerings of different types of market centers is a bad thing," and suggested that allowing for flexible pricing increments might drive innovation and effective execution of trades more effectively than mandating uniform pricing

[77] Reg. NMS Trading Amendments Proposing Release, *supra* note 4.
[78] *Id.* at 80267.
[79] *Id.*
[80] See Commissioner Hester M. Peirce, Statement on Proposal to Amend Rules Governing Access Fees and Tick Sizes and to Accelerate Certain Market Data Changes (Dec. 14, 2022), available here; Commissioner Mark T. Uyeda, Statement on Proposed Rule Regarding Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders (Dec. 14, 2022), available here.

increments.[81] She also commented that the proposed "reforms appear to establish requirements that favor exchanges and certain ATSs over other firms providing trade execution services."[82]

I. Variable Tick Sizes

Rule 612 of Reg. NMS currently prohibits national securities exchanges, national securities associations, ATSs, vendors and broker-dealers from displaying, ranking or accepting quotations, orders or indications of interest in any NMS Stocks priced in an increment smaller than $0.01 if the quotation, order, or indication of interest is priced at or greater than $1.00 per share. To address concerns about so-called "tick-constrained" stocks,[83] the SEC proposed to modify Rule 612 to: (i) introduce a variable tick size structure for quotes and orders in NMS Stocks priced at or greater than $1.00 per share; and (ii) require executions to occur in the minimum tick size, both on-exchange and in the OTC market, subject to certain exceptions.[84] The SEC did not propose to modify the tick size for NMS Stocks that are priced at less than $1.00 per share, which is $0.0001.[85]

The proposed Reg. NMS Trading Amendments would vary the tick size for quotations, orders and indications of interest in NMS Stocks priced at $1.00 or more based on a "Time Weighted Average Quoted Spread," which would be calculated by the primary listing exchange for the particular NMS Stock on a quarterly basis during a month-long "Evaluation Period."[86] The "Time Weighted Average Quoted Spread" would be defined as the average dollar value difference between the NBB and NBO during regular trading hours where each instance of a unique NBB and NBO is weighted by the length of time that the quote prevailed as the NBB or NBO.[87] Under the Reg. NMS Amendments, one of the following four tick sizes would apply, depending on the Time Weighted Average Quoted Spread for the NMS Stock:

- $0.001 if the Time Weighted Average Quoted Spread for the NMS Stock during the Evaluation Period was equal to or less than $0.008;

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81 *See supra* n.78 and accompanying text.

82 *Id.*

83 The SEC noted that the current minimum pricing increment creates an artificial price constraint on certain NMS stocks and prevents so-called "tick-constrained stocks" from reaching a natural price that would be within a penny spread. In addition, the Reg. NMS Trading Amendments Proposing Release noted concerns that OTC market makers hold a competitive advantage over other market participants under existing requirements with respect to sub-penny trading. Reg. NMS Trading Amendments Proposing Release, *supra* note 4, at 80271–76.

84 Proposed Rule 612(a)-(f).

85 *See* Reg. NMS Trading Amendments Proposing Release, *supra* note 4, at 80283.

86 *See* Proposed Rule 612(a). The "Evaluation Period" would be defined as the last month of a calendar quarter (March in the first quarter, June in the second quarter, September in the third quarter and December in the fourth quarter) of a calendar year during which the primary listing exchange shall measure the Time Weighted Average Quoted Spread of an NMS stock that is priced equal to, or greater than, $1.00 per share to determine the minimum pricing increment to be in effect for an NMS stock for the next calendar quarter. *See* Reg. NMS Trading Amendments Proposing Release, *supra* note 4, at 80283–84.

87 Proposed Rule 612(a)(i). *See* Reg. NMS Trading Amendments Proposing Release, *supra* note 4, at 80282.

- $0.002 if the Time Weighted Average Quoted Spread for the NMS Stock during the Evaluation Period was greater than $0.008 but less than or equal to $0.016;
- $0.005 if the Time Weighted Average Quoted Spread for the NMS Stock during the Evaluation Period was greater than $0.016 but less than, or equal to, $0.04; and
- $0.01 if the Time Weighted Average Quoted Spread for the NMS Stock during the Evaluation Period was greater than $0.04.[88]

The proposed tick sizes would apply to all trading of NMS Stock, whether carried out on national securities exchanges, on ATS or in the OTC market, unless an exemption applies. Exemptions would be provided for: (i) orders that execute, but are not explicitly priced, at the midpoint of the NBBO or the protected bid and protected offer ("**PBBO**"); and (ii) orders that execute at a price that was not based, directly or indirectly, on the quoted price of an NMS Stock at the time of execution and for which the material terms were not reasonably determinable at the time the commitment to execute the order was made (*e.g.*, volume-weighted average price ("**VWAP**") trades or time-weighted average price ("**TWAP**") trades).[89] If adopted, the implementation of the proposed tick sizes would be staggered over three implementation periods covering five quarters.[90]

The proposed NMS Trading Amendments would also amend the definition of "regulatory data" in Rule 600(b)(78) of Reg. NMS to require the primary listing exchange for each NMS Stock to calculate and provide to competing consolidators, self-aggregators, and the exclusive SIPs an indicator of the applicable tick size that would be required under the Reg. NMS Trading Amendments.[91]

The proposed Reg. NMS Trading Amendments would except orders that execute at, but are not explicitly priced at, the midpoint between the NBB and the NBO or the midpoint between the best protected bid and the best protected offer as well as orders that execute at a price that was not based, directly or indirectly, on the quoted price of an NMS Stock at the time of execution and for which the material terms were not reasonably determinable at the time the commitment to execute the order was made. In addition, the proposed rule provides the SEC with authority to exempt any person, security, quotation, or order, or any class or classes of persons, securities, quotations, or orders, if the SEC determines that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors.

[88] *See* Proposed Rule 612(a). The Reg. NMS Trading Amendments Proposing Release noted that an NMS stock could have a different minimum pricing increment every quarter of the calendar year. *See* Reg. NMS Trading Amendments Proposing Release, *supra* note 4, at 80280.

[89] Proposed Rule 612(e)(1). *See* Reg. NMS Trading Amendments Proposing Release, *supra* note 4, at 80283.

[90] *See* Reg. NMS Trading Amendments Proposing Release, *supra* note 4, at 80284.

[91] *Id.* at 80299.

II. Reductions in Exchange Access Fees for Quotations

The proposed Reg. NMS Trading Amendments would incorporate a variable access fee cap structure for exchange access fees and reduce the level of access fee caps, which limit the fees that can be charged for trading against the best priced quotations displayed in any market.[92] Rule 610(c) of Reg. NMS prohibits trading centers from imposing, or permitting to be imposed, any fee or fees for the execution of an order against a protected quotation of the trading center or any other quotation of the trading center that is the best bid or best offer of an exchange or association in an NMS Stock that exceeds or accumulates to more than $0.0030 per share if the price of the protected quotation or other quotation is $1.00 or more per share. Rule 610 currently imposes an access fee cap of 0.3% of the quotation price per share if the price of the protected quotation or other quotation is less than $1.00 per share.[93]

Under the proposed Reg. NMS Amendments, if the protected quotation or other quotation in an NMS Stock is priced at $1.00 or more per share, the fee or fees assessed to execute against such quotation would not be permitted to exceed: (i) $0.0005 per share for NMS Stocks with a tick size of $0.001; and (ii) $0.001 per share for NMS Stocks with a tick size greater than $0.001. The access fee cap for an execution against a protected quotation or other quotation priced less than $1.00 per share would be reduced to 0.05% of the quotation price. The access fee caps would continue to apply to executions against protected quotations and not to the fees of trading centers that do not display protected quotations, such as ATSs or OTC market makers, or to non-displayed interest or depth-of-book quotes.[94] The proposed Reg. NMS Trading Amendments would also prohibit a national securities exchange from imposing or permitting to be imposed any fee, rebate, or other remuneration for the execution of an order in an NMS Stock if such fee, rebate, or remuneration cannot be determined at the time of execution.

III. Requirement that Exchange Fees and Rebates Be Determinable at Time of Execution

The Reg. NMS Trading Amendments Proposing Release noted that the fees charged by and the rebates granted by regulated securities exchanges are typically calculated at the end of the month, which impedes the ability of market participants to understand at the time of execution the full cost of the transaction.[95] The SEC proposed to add a new subsection (d) to Rule 610 of Reg. NMS that would prohibit a national securities exchange from imposing, or permitting to be imposed, any fee or fees, or providing, or permitting to be provided, any rebate or other remuneration (*e.g.*, discounted fees, other credits, or forms of linked pricing) for the execution of an order in an NMS Stock unless such fee, rebate or other remuneration can be determined at the time of execution.[96] Under the proposal, any national securities exchange that imposes a fee or provides a rebate that is based on a certain volume threshold, or establishes tier requirements or

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92 *Id.* at 80291. The SEC also proposed to delete now-redundant references to “The Nasdaq Stock Market, Inc.” in Rule 610(c). *Id.* at 80292.
93 *Id*. at 80288.
94 *Id.* at 80286–87.
95 *Id*. at 80292.
96 *See id*. at 80292.

tiered rates based on minimum volume thresholds, would be required to set these volume thresholds or tiers using the volume achieved during a stated period ahead of the execution time, so that market participants can immediately determine what fee or rebate level would be applicable to any submitted order at the time of execution.[97]

IV. Accelerated Implementation of Adoption of Definitions of Odd-Lot Information and Round Lot

The SEC proposed to accelerate the implementation of the "odd-lot information" and "round lot" definitions previously adopted in 2020 in light of the delay in implementation of the Market Data Infrastructure Rules ("**MDI Rules**").[98] As implementation of the MDI Rules has stalled, the Reg. NMS Trading Amendments would "accelerate the implementation of the round lot and odd-lot information definitions [under the MDI Rules] so that market participants can reap the benefits of increased transparency and enhanced execution quality sooner than originally planned."[99] Specifically, the Commission proposes to require compliance with the round lot and odd-lot information definitions 90 days from the publication of any Commission adoption of an earlier implementation of the round lot and odd-lot information definitions in the Federal Register.[100]

Odd-Lot Information. Odd-lot information is defined under the MDI Rules as: (i) odd-lot transactions; and (ii) odd lots at a price greater than or equal to the NBB and less than or equal to the NBO, aggregated at each price level at each national securities exchange and national securities association.[101] To accelerate the compliance date for odd-lot information, the SEC proposed to require national securities exchanges and national securities associations to provide the data necessary to generate odd-lot information to the exclusive SIPs and to require the exclusive SIPs to collect, consolidate, and disseminate odd-lot information.[102]

Round Lot. The MDI Rules assign each NMS Stock to a round lot size based on the stock's share price.[103] Round lot is defined in rule 600(b)(82)(i)-(v) and encompasses the following:

- For any NMS Stock for which the prior calendar month's average closing price on the primary listing exchange was $250.00 or less per share, an order for the purchase or sale of an NMS Stock of 100 shares;

[97] *Id.* at 80292.

[98] *See id.* at 80295 n.357 and accompanying text. *See* Market Data Infrastructure, Exchange Act Release No. 90610 (Dec. 9, 2020) [86 FR 18596 (Apr. 9, 2021)], available here.

[99] *See* 87 Fed. Reg. at 80298.

[100] *See id.*

[101] 17 CFR 242.600(b)(59). Once implemented, information about odd-lot orders priced better than the NBBO will be included in the NMS data that is made available to market participants within the national market system.

[102] *See* Reg. NMS Trading Amendments Proposing Release, *supra* note 4, at 80298. The Reg. NMS Amendments would not affect the compliance date for the provision of consolidated market data by competing consolidators and self-aggregators pursuant to the decentralized consolidation model set forth in the MDI Rules.

[103] *See id.* at 80294.

- For any NMS Stock for which the prior calendar month's average closing price on the primary listing exchange was $250.01 to $1,000.00 per share, an order for the purchase or sale of an NMS Stock of 40 shares;
- For any NMS Stock for which the prior calendar month's average closing price on the primary listing exchange was $1,000.01 to $10,000.00 per share, an order for the purchase or sale of an NMS Stock of 10 shares;
- For any NMS Stock for which the prior calendar month's average closing price on the primary listing exchange was $10,000.01 or more per share, an order for the purchase or sale of an NMS Stock of 1 share; and
- For any NMS Stock for which the prior calendar month's average closing price is not available, an order for the purchase or sale of an NMS Stock of 100 shares.[104]

To facilitate the accelerated implementation of the round lot definition, the definition of "regulatory data" in Rule 600(b)(78) of Reg. NMS would be amended to require the primary listing exchanges to make indicators of the applicable round lot size available to the exclusive SIPs.[105] Because the exclusive SIPs would be required to collect and disseminate SIP data in the new round lot sizes, the SEC also proposed to require the exclusive SIPs to represent quotation sizes in SIP data in terms of the number of shares and to round quotation sizes, except for odd-lot quotations, down to the nearest multiple of round lot.[106]

The proposed changes are designed to allow market participants to identify the best priced odd-lot orders and have access to additional information to make their execution determinations.[107] If adopted, exclusive consolidated SIPs, which currently disseminate quotation information regarding NMS Stocks, would be required to disseminate the odd-lot information until the decentralized model for consolidation and dissemination of NMS Stock data, adopted as part of the SEC's 2020 amendments to Reg. NMS, is implemented (which is expected in the future). Under the decentralized model, "competing consolidators" will replace SIPs in collecting, consolidating and disseminating the data.[108]

The SEC also proposed to amend the definition of odd-lot information to include a specified best odd-lot order to buy and best odd-lot order to sell.[109] The best odd-lot order to buy would mean the highest priced odd-lot order to buy that is priced higher than the NBB, and the best odd-lot order to sell would mean the lowest priced odd-lot order to sell that is priced lower than the NBO. Odd-lot buy or sell orders having the same price would be required to be ranked first by size (giving

[104] 17 CFR § 242.600(b)(82).

[105] *See* Reg. NMS Trading Amendments Proposing Release, *supra* note 4, at 80299. The compliance date for this requirement would coincide with the proposed compliance date for the round lot definition. *See id.* at 80299 n.386.

[106] *Id.* at 80299.

[107] *Id.* at 80270.

[108] *Id.* at 80294.

[109] *Id.* at 80301–02.

the highest ranking to the odd-lot buy order or odd-lot sell order associated with the largest size), and then by time of receipt (giving the highest ranking to the odd-lot buy order or odd-lot sell order received first in time).[110]

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[110] *Id.* at 80302.

Appendix IV
Reg. NMS Disclosure Amendments

The Reg. NMS Disclosure Amendments would amend Rule 605 of Reg. NMS to update the disclosure required for order executions in NMS Stocks and expand the entities required to publish the information.[111] The proposed amendments to Rule 605 would capture execution quality information for more order types and sizes by modifying the definition of "covered order," and would require time-based metrics to be recorded at a more granular level. The information in the reports is designed to promote visibility and competition on the part of market centers and broker-dealers, particularly with respect to execution price and speed.[112] The Reg. NMS Disclosure Amendments would also require market centers to make summary reports available.

I. Scope of Reporting Entities

Currently only "market centers" are required to publish and make publicly available standardized monthly execution quality reports regarding NMS Stock.[113] A "market center" is any exchange market maker, OTC market maker, ATS, national securities exchange or national securities association.[114] The Reg. NMS Disclosure Amendments would expand the scope of entities subject to Rule 605 reporting requirements to include: (i) broker-dealers that introduce or carry 100,000 or more customer accounts for the purpose of executing transactions in NMS Stocks; and (ii) entities that would operate the qualified auctions proposed in the Order Competition Rule. In addition, because NMS Stock ATSs, which are "market centers" under Rule 605, are often operated by broker-dealers that have separate lines of business that are distinct from their ATSs but which may also relate to the trading of NMS Stocks, the proposed amendments would clarify that ATSs and dark pools (*i.e.*, ATSs that do not publish quotations) would be required to report separately from their affiliated broker-dealers under Rule 605. Similarly, given that certain OTC market makers, including wholesalers, operate single-dealer platforms through which they execute institutional orders in NMS Stocks against their own inventory, the amendments would require that the single-dealer platforms that target particular groups of customers or types of orders report their execution quality statistics separately from their associated broker-dealers. As a result, for these entities, the execution quality report would relate to covered orders submitted to such routing destination.[115]

Broker-Dealers. The Reg. NMS Disclosure Amendments would expand the scope of entities that must prepare Rule 605 reports to include larger broker-dealers. In order to trigger the reporting requirement, a broker-dealer would be required to carry or introduce 100,000 or more customer accounts through which purchases or sales are made in NMS Stocks (the "**customer account threshold**"). The time period for posting standardized reports by such larger broker-dealers will be

111 *See* Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5.

112 *See* Rule 605.

113 The reports must continue to be publicly available for at least three years from the initial posting on a free and readily accessible internet website. Rule 605(a).

114 *See* Rule 600(b). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3788.

115 *See* Proposed Rule 605(a).

the same as for market centers, if the larger broker-dealer would otherwise meet the definition of market center, and separate reports must be published for each function. However, a broker or dealer that meets or exceeds the customer account threshold shall be required to produce reports only for three calendar months. The three-month period would begin on the first calendar day of the next calendar month after the broker or dealer met or exceeded the customer account threshold, unless it was the first time the broker-dealer had met or exceeded the customer account threshold, in which case reporting would be required to begin the first calendar day four calendar months later. If, at any time after a broker-dealer is required to produce reports under the proposed amendments for at least three months, the broker or dealer falls below the customer account threshold, the broker or dealer may stop producing reports for the next calendar month.

Time of Order Receipt. Rule 605 currently requires that market centers calculate statistics included in the reports based on the "time of order receipt." Under the amendments, for broker-dealers that are not market centers, the time of order receipt would be the time at which the customer order was initially received by the broker-dealer for execution, even when the broker-dealer routes the order away.[116] The Reg. NMS Disclosure Proposing Release noted that "[m]easuring 'time of order receipt' based on when a broker-dealer received the order would provide a view of how that broker-dealer handled that order from the time the order was within its control" and thereby "could provide information about whether a broker-dealer's delay in sending the order to a market center for execution may have affected the execution quality obtained for that order . . . ."[117]

Qualified Auction Mechanisms. The Reg. NMS Disclosure Amendments would require market centers that operate qualified auctions for customer orders under the Order Competition Rule to prepare separate reports pursuant to Rule 605 pertaining only to covered orders received for execution in those qualified auctions.[118] This proposed requirement for separate reports is limited to market centers that operate proposed qualified auctions, and would not extend to market centers or broker-dealers that route orders away for execution in a qualified auction (as discussed in the proposed Order Competition Rule).[119]

ATSs and SDPs. The Reg. NMS Disclosure Amendments would require ATSs and single-dealer platforms to produce Rule 605 reports specific to their activity as an ATS and single-dealer platform.[120] In particular, ATSs would be required to prepare reports separately from their broker-dealer operators, to the extent such entities are required to prepare reports. Single-dealer platforms that provide a routing destination for particular customers or orders would be required to produce a separate report pertaining only to covered orders submitted to such routing destination.

116 Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3797.
117 *Id.* at 3799.
118 *See* Proposed Rule 605(a)(1). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3801.
119 Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3802.
120 *See* Proposed Rule 605(a)(1). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3803.

II. Scope of Covered Orders

Orders Submitted Pre-Opening/Post-Closing. Currently, Rule 605 reports are only required to include orders received during regular trading hours at a time when the NBBO is being disseminated.[121] The Reg. NMS Disclosure Amendments would expand the scope of the Rule to include non-marketable limit orders received by a market center, broker, or dealer outside of regular trading hours or at a time when an NBBO is not being disseminated and, if executed, are executed during regular trading hours.[122]

The definition of "marketable limit order" under Rule 605 would be amended to specify that the marketability of an order received when an NBBO is not being disseminated would be determined using the NBBO that is first disseminated after the time of order receipt.[123] Any limit order received outside of regular trading hours or during a trading halt that is marketable based on the first disseminated NBBO during regular trading hours after the time of order receipt would not be a covered order for purposes of Rule 605.[124] In addition, the SEC proposed to incorporate existing exemptive relief into the proposed definition of covered order with respect to market or limit orders received during regular trading hours at a time when an NBBO is being disseminated. This exemptive relief exempts orders from inclusion in Rule 605 reports that are received prior to the dissemination of the primary listing market's first firm, uncrossed quotations for a trading day.[125] Finally, the Reg. NMS Execution Disclosure Amendments would require a covered order to be included in the report for the month in which it becomes executable if the day of receipt and the day it initially becomes executable occur in different calendar months.[126]

Stop Orders and Orders for which Special Handling is Requested. The proposed amendments would retain the exclusion for orders for which a customer requests special handling, such as "market on open" and "market on close" orders, "all or none" orders and "not held" orders. These orders are excluded based on a presumption that special handling instructions could skew general execution quality measures.[127] In a change to the exclusion, the proposed amendments would make stop orders subject to the rule. The Reg. NMS Disclosure Proposing Release noted that market centers and broker-dealers may differ in how they handle stop orders and added that the current lack of consistent information regarding execution of such orders may prevent investors from comparing the execution quality.[128] The Reg. NMS Disclosure Proposing Release noted that because "stop orders are likely to hit their stop prices, and are often executed, during

121 Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3804.

122 *Id.*

123 *Id.* A marketable limit order is a buy order with a limit price equal to or greater than the NBB at the time of order receipt, or any sell order with a limit price equal to or less than the NBB at the time of order receipt.

124 *See* Proposed Rule 600(b)(57). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3804.

125 *See* Rule 600(b)(30). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3805.

126 Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3805.

127 *Id.* at 3789.

128 *Id.* at 3805.

periods of price volatility or downwards market momentum," they are not executed during favorable execution conditions.[129] The Reg. NMS Disclosure Proposing Release indicated that amending the rules to include stop orders in the Rule 605 report would "benefit market participants by allowing them to analyze these variations in execution quality" and "provide a more complete view of the orders certain broker-dealers may use when assessing the execution quality market centers provide."[130] Under the proposed amendments, the execution quality of orders submitted with stop prices would be measured from the time their stop prices are reached (*i.e.*, when the order becomes executable).[131] For any buy order submitted with a stop price, "executable" would mean that the stop price is equal to or greater than the NBB during regular trading hours. For any sell orders submitted with a stop price, "executable" would mean that the stop price is equal to or less than the NBO during regular trading hours.[132] In practice, this will mean that stop orders would be reported as part of a Rule 605 report only if they become executable, and the point at which a stop order first becomes executable would be used as a benchmark for several execution-quality metrics, including average effective spread, average effective over quoted spread, average realized spread, and average time to execution statistics.[133]

Non-Exempt Short-Sale Orders. The SEC staff historically has viewed all short sale orders that are not marked "short-exempt" ("**non-exempt short sale orders**") as special handling orders (*i.e.*, orders with special handling instructions), and thus excluded from the definition of covered orders for purposes of Rule 605.[134] Under the Reg. NMS Disclosure Amendments, however, non-exempt short sale orders would no longer be considered special handling orders unless a price restriction is in effect for the security.[135] Non-exempt short sale orders would fall within the definition of covered orders, and thus be subject to Rule 605 reporting requirements, unless an exclusion applies.[136]

III. Required Information Under Rule 605

Rule 605 reports group orders by both order size and type and requires certain standardized information for all types of orders, and additional information for market orders and marketable limit orders.[137] The Reg. NMS Disclosure

[129] *Id*.
[130] *Id*.
[131] *See* Proposed Rule 600(b)(20). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3805.
[132] *See* Proposed Rule 600(b)(42). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3805.
[133] Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3805.
[134] *Id*. at 3806. The SEC staff's position was based in part on the fact that non-exempt short sale orders are subject to a price test under Rule 201 of Regulation SHO, which sets forth a short sale circuit breaker that is triggered in certain circumstances, after which a price restriction will apply to short sales orders in a security for that day and the following day.
[135] *See* Proposed Rule 600(b)(30). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3806.
[136] Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3806. The SEC explained that a short sale order marked "exempt" during a short sale price test would be subject to special handling, excluding it from the definition of a covered order and the Rule 605 reporting requirements.
[137] *Id*. at 3803.

Amendments would modify the current order size and order type categorizations and change the required information for: all types of orders; market and marketable limit order types; and non-marketable order types.[138]

A. Categorization by Order Size

Rule 600(b)(13) defines "categorized by order size" as the division of orders into categories based on the number of shares composing an order.[139] Currently, the largest category consists of orders greater than 5,000 shares and less than 10,000 shares.[140] The Reg. NMS Disclosure Amendments would replace the current categories and instead use a new set of categories based on the number of round lots in an order.[141] Historically, round lots have been defined as groups of 100 shares under Rule 605.[142] The proposed order size categories would be: (i) less than 1 share; (ii) odd-lot; (iii) 1 round lot to less than 5 round lots; (iv) 5 round lots to less than 20 round lots; (v) 20 round lots to less than 50 round lots; (vi) 50 round lots to less than 100 round lots; and (vii) 100 round lots or greater.[143] In addition to using the new definition of round lot, the SEC proposed new categories for odd-lot orders (*i.e.*, fewer than 100 shares), orders less than a share (*i.e.*, fractional shares), and "larger sized orders" (*i.e.*, greater than 10,000 shares).[144]

B. Categorization by Order Type

The SEC proposed to modify the definition of "categorized by order type" under Rule 605(a)(1). Currently, "categorized by order type" means dividing orders into five categories for: (i) market orders; (ii) marketable limit orders; (iii) inside-the-quote orders; (iv) at-the-quote limit orders; and (v) near-the-quote limit orders.[145]

The SEC proposed to modify this definition to divide orders into six separate categories for: (i) market orders; (ii) marketable limit orders (excluding IOCs); (iii) marketable IOCs; (iv) beyond-the-midpoint limit orders (*i.e.*, limit orders priced more aggressively than the midpoint); (v) executable non-marketable limit orders (excluding beyond-the-midpoint

138 *Id.* at 3803–04.
139 *Id.* at 3807.
140 *Id.*
141 *Id.*
142 *Id.*
143 *See* Proposed Rule 600(b)(19). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3807.
144 Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3807. The Reg. NMS Disclosure Amendments would rescind exemptive relief issued in 2001 for larger sized orders. *Id.* at 3808.
145 *See* Rule 600(b)(14). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3809. Inside-the-quote limit order, at-the-quote limit order, and near-the-quote limit orders mean non-marketable buy orders with limit prices that are, respectively, higher than, equal to, and lower by $0.10 or less than the NBO at the time of order receipt. Under the Reg. NMS Disclosure Amendments, these categories would be eliminated. Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3809 n.294.

limit orders and orders submitted with stop prices); and (vi) executable orders submitted with stop prices.[146] The following table compares the order type categories under the current Rule to the proposed new order type categories:

Existing Order Type Category	**Order Type Category as Proposed**
Market	Market Marketable IOC
Marketable Limit	Marketable Limit Marketable IOC
Inside-the-Quote Limit	Beyond-the-Midpoint Limit Executable Non-Marketable Limit Order
At-the-Quote Limit	Executable Non-Marketable Limit Order
Near-the-Quote Limit	Executable Non-Marketable Limit Order[147]
Not Included[148]	Executable Non-Marketable Limit Order Executable Stop

As proposed, Rule 605 statistics would be collected for "executable" non-marketable limit orders.[149] The proposed definition of "executable" for non-marketable limit orders (other than orders submitted with stop prices) is: for any non-marketable buy order (excluding orders submitted with stop prices), executable means that the limit price is equal to or greater than the NBB during regular trading hours, and, for any non-marketable sell order (excluding orders submitted with stop prices), that the limit price is equal to or less than the NBO during regular trading hours.[150] As is the case for

146 *See* Proposed Rule 600(b)(20). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3809. Currently, marketable IOCs are grouped together with other marketable orders under Rule 605. *See* Rule 600(b)(14). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3811.

147 Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3809. Under the Reg. NMS Disclosure Amendments, near-the-quote limit orders would fall outside the scope of the order type categories if they do not become executable. *Id.* at 3809 n.291.

148 *Id.* The following orders fall outside the scope of the current order type categories: (i) nonmarketable buy orders and non-marketable sell orders with limit prices that are more than $0.10 lower than the NBB or higher than the NBO, respectively, at the time of order receipt; and (ii) stop orders. Under the Reg. NMS Disclosure Amendments, such orders, if they become executable, would fall within the order types for executable non-marketable limit orders or executable stop orders. However, these orders would fall outside the scope of the order type categories as proposed if they do not become executable. *Id.* at 3809 n.292.

149 *Id.* at 3810.

150 *See* Proposed Rule 600(b)(42). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3810.

orders submitted with stop prices, incorporation of the "executable" concept would have two effects.[151] First, non-marketable limit orders would only be reported as part of a Rule 605 report if they become executable during regular trading hours.[152] Second, the point that a non-marketable limit order first becomes executable would be used as an input for several execution quality metrics.[153] Additionally, the Reg. NMS Disclosure Amendments would require that the execution quality statistics for beyond-the-midpoint limit orders include the additional information required of both marketable and non-marketable order types.[154]

C. Timestamp Conventions

Rule 605 reports currently are required to include information on the number of shares of covered orders executed within certain timeframes, measured by seconds after the time of order receipt.[155] The Reg. NMS Disclosure Amendments would update the reporting requirements to require that the following be measured and recorded in increments of a millisecond or finer: (i) time of order receipt; (ii) time of order execution; (iii) average "time-to-execution" figures for marketable order types; and (iv) the time an order becomes executable.[156] Further, the current time-to-execution buckets, which group orders based on the time it takes to be executed, would be eliminated, in favor of average time to execution, median time to execution and 99th percentile time to execution, each measured in increments of a millisecond or finer.[157] The SEC proposed to require share-weighted median and 99th percentile time to execution for all order types.[158]

D. Changes to Information Required for All Types of Orders

The Reg. NMS Disclosure Amendments would change the information required for calculating realized spread, average effective spread, percentage spreads (effective and realized), average effective over quoted spreads, size improvement, and riskless principal. Rule 605 requires these calculations be made in order to measure the quality of execution of different types of orders.

Realized Spread. Rule 605 requires calculation of average realized spread for executions of all covered orders and is calculated by comparing the execution price of an order and the midpoint of the NBBO as it stands five minutes after the

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[151] Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3810.
[152] *See* Proposed Rule 600(b)(20). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3810.
[153] Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3810.
[154] *See* Proposed Rule 605(a)(1)(ii)–(iii). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3811.
[155] Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3812.
[156] *Id.* at 3812.
[157] *Id.* at 3825.
[158] *Id.* at 3813.

time of order execution.[159] The Reg. NMS Disclosure Amendments would modify the time horizon used to calculate the realized spread from a single horizon of five minutes to two horizons: 15 seconds and 1 minute.[160]

Average Effective Spread. Rule 600(b)(8) defines "average effective spread" as the share-weighted average of effective spreads for order executions calculated, for buy orders, as double the amount of difference between the execution price and the midpoint of the NBBO at the time of order receipt and, for sell orders, as double the amount of difference between the midpoint of the NBBO at the time of order receipt and the execution price.[161] Currently, average effective spread is required to be calculated only for market and marketable limit order types and doing so requires the comparison of the execution price of an order with the midpoint of the NBBO at the time of order receipt. The Reg. NMS Disclosure Amendments would expand effective spread reporting requirements to include all covered orders, and to modify the methodology for calculating this metric for executable non-marketable limit orders, beyond-the-midpoint limit orders, and executable stop orders.[162] In addition, the definition of "average effective spread" would be revised to specify that, for order executions of non-marketable limit orders and orders submitted with stop prices, average effective spread is calculated from the time the order becomes executable.[163]

Percentage Spreads (Effective and Realized). The SEC proposed to require dollar-based spread statistics (*i.e.*, effective spread and realized spread) also to be reported as percentages. Under the proposed Reg. NMS Disclosure Amendments, the definitions for "average percentage effective spread" and "average percentage realized spread" would provide the same calculation as the dollar-based effective and realized spread statistics for the numerator, but the denominator for dollar-based spread percentages would be the midpoint of the NBBO at either the time of order receipt (for marketable order types) or the time an order first becomes executable (for non-marketable order types).[164] This would then be averaged on a share-weighted basis for the month.[165]

159 *Id.* at 3814.

160 *See* Proposed Rule 605(a)(1)(i)(G) and (I). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3815 n.375.

161 *See* Rule 600(b)(8). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3816. Average effective spread is used as a measure of the spread paid by investors at a particular market center and can provide information on the price paid for the immediacy of execution or the amount that a liquidity provider could expect to earn.

162 Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3816.

163 *See* Proposed Rule 600(b)(10). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3816.

164 Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3817.

165 *Id.*

Effective Over Quoted Spread (E/Q). The SEC proposed to require, for executions of all covered orders, a statistic for the average effective over quoted spread, expressed as a percentage.[166] Rule 605 does not currently require quoted spreads to be reported, although average quoted spread can be derived from existing Rule 605 statistics.[167]

Size Improvement. Currently, Rule 605 reports are required to include price improvement metrics but do not indicate whether orders received an execution of more than the displayed size at the quote.[168] The SEC proposed to add a benchmark metric to Rule 605 that would, in combination with information about execution sizes, indicate the level of size improvement (*i.e.*, whether orders received an execution greater than the displayed size at the quote).[169] Specifically, the proposed Reg. NMS Disclosure Amendments would require, for executions of all covered orders, the reporting of the cumulative number of shares of the full displayed size of the protected bid at the time of execution, in the case of a market or limit order to sell; and for the full displayed size of the protected offer at the time of execution for buy and sell orders, respectively.[170]

Riskless Principal. At present, a market center that executes the riskless principal leg of a trade (*i.e.*, the receiving market center) typically reports those orders in its Rule 605 statistics as part of the cumulative number of shares of covered orders that were executed at the receiving market center under Rule 605(a)(1)(i)(D).[171] The SEC proposed to carve riskless principal orders out from Proposed Rule 605(a)(1)(i)(D) by providing that the number of shares of covered orders executed at the receiving market center, broker, or dealer excludes shares that the market center, broker, or dealer executes on a riskless principal basis.[172] As a result, a market center that executes a riskless principal order would include these shares as part of the cumulative number of shares executed at any other venue under Rule 605(a)(1)(i)(E), and only the market center that executes the corresponding principal order would include those shares as part of the cumulative number of shares executed at the receiving market center.

E. Additional Required Information for Order Types

Market, Market Limit, Marketable IOC, and Beyond-the-Midpoint Limit Orders. The SEC proposed to add a definition of "best available displayed price," which would include the best priced odd-lot if that price is inside the NBBO.[173] The "best available displayed price" would mean, for an order to buy (sell), the lower (higher) of: (i) the NBB (bid) at the time of order

[166] *See* Proposed Rule 605(a)(1)(i)(M). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3817. E/Q is generally expressed as a percentage that represents how much price improvement an order received. An E/Q of 100% means a buy order was executed at the national best offer or a sell order was executed at the national best bid. An E/Q of 0% means an order was executed at the midpoint of the NBBO.

[167] Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3817.

[168] *Id*.

[169] *Id.* at 3818.

[170] Proposed Rule 605(a)(1)(i)(F). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3818.

[171] Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3819.

[172] *See* Proposed Rule 605(a)(1)(i)(D). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3819.

[173] Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3820.

receipt or (ii) the price of the best odd-lot order to sell (buy) at the time of order receipt as disseminated pursuant to an effective transaction reporting plan or effective national market system plan.[174] For beyond-the-midpoint limit orders, the best available displayed price would be determined at the time the order becomes executable rather than the time of order receipt.[175]

The SEC further proposed adding two definitions relating to the best available displayed price. "Executed outside the best available displayed price" would mean, for buy orders, execution at a price higher than best available displayed price; and, for sell orders, execution at a price lower than the best available displayed price.[176] "Executed with price improvement relative to the best available displayed price" would mean, for buy orders, execution at a price lower than the best available displayed price and, for sell orders, execution at a price higher than the best available displayed price.[177]

The Reg. NMS Disclosure Amendments also would add additional price improvement statistics that are specifically related to the best available displayed price and would require the reporting of:

- the cumulative number of shares of NMS Stock included in covered orders executed with price improvement relative to the best available displayed price;
- for shares executed with price improvement relative to the best available displayed price, the share-weighted average amount per share of NMS Stock that prices were improved as compared to the best available displayed price;
- the cumulative number of shares of NMS Stock included in covered orders executed at the best available displayed price;
- the cumulative number of shares of NMS Stock included in covered orders executed outside the best available displayed price; and
- for shares of NMS Stock executed outside the best available displayed price, the share-weighted average amount per share of NMS Stock that prices were outside the best available displayed price.[178]

Executable Non-Marketable Limit Orders, Executable Stop Orders and Beyond-the-Midpoint Limit Orders. The Reg. NMS Disclosure Amendments would add requirements for reporting additional information about the execution quality of non-

174 *See* Proposed Rule 600(b)(14). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3820.
175 Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3820.
176 *See* Proposed Rule 600(b)(44). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3820.
177 *See* Proposed Rule 600(b)(47). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3820.
178 *See* Proposed Rule 605(a)(1)(ii). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3820.

marketable limit orders and orders submitted with stop prices.[179] Specifically, Proposed Rule 605(a)(1)(iii) would require the reporting of the number of orders that received either a complete or partial fill.[180] It also would require the reporting of the cumulative number of shares executed the regular way at prices that could have filled the order while the order was in force, as reported pursuant to an effective transaction reporting plan or effective national market system plan.[181]

IV. Summary Execution Quality Reports

Currently, Rule 605 requires market centers to prepare detailed execution quality statistics and make this data available via large electronic data files.[182] The Reg. NMS Disclosure Amendments would require all market centers and larger broker-dealers subject to Rule 605 reporting obligations to produce detailed summary execution quality statistics, in addition to the more detailed reports required by Rule 605(a)(1).[183] Proposed Rule 605(a)(2) would require every market center, broker, or dealer to make publicly available for each calendar month a report providing summary statistics on all executions of covered orders that are market and marketable limit orders that it received for execution from any person.[184] These statistics would include data on all executions of covered orders that are market and marketable limit orders received for execution from any person.[185] Other order types, such as non-marketable limit orders would not be included in the summary reports. The proposed amendments would also require that the summary reports must be made available using the most recent version of the XML schema and the associated PDF renderer published on the SEC website.[186]

179 Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3821.
180 *See* Proposed Rule 605(a)(1)(iii)(A). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3821.
181 *See* Proposed Rule 605(a)(1)(iii)(B). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3821.
182 Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3822.
183 *Id.* at 3822.
184 *Id.* at 3823.
185 *Id.*
186 *See* Proposed Rule 605(a)(2). Reg. NMS Disclosure Amendments Proposing Release, *supra* note 5, at 3824.

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