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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 242

[Release No. 34-84528; File No. S7-14-16]

RIN 3235-AL67

Disclosure of Order Handling Information

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") is adopting amendments to Regulation National Market System ("Regulation NMS") under the Securities Exchange Act of 1934 ("Exchange Act") to require additional disclosures by broker-dealers to customers regarding the handling of their orders. The Commission is adding a new disclosure requirement which requires a broker-dealer, upon request of its customer, to provide specific disclosures related to the routing and execution of the customer's NMS stock orders submitted on a not held basis for the prior six months, subject to two de minimis exceptions. The Commission also is amending the current order routing disclosures that broker-dealers must make publicly available on a quarterly basis to pertain to NMS stock orders submitted on a held basis, and the Commission is making targeted enhancements to these public disclosures. In connection with these new requirements, the Commission is amending Regulation NMS to include certain newly defined and redefined terms that are used in the amendments. The Commission also is amending Regulation NMS to require that the public order execution report be kept publicly available for a period of three years. Finally, the Commission is adopting

conforming amendments and updating cross-references as a result of the rule amendments being adopted in this rule.

DATES: *Effective date:* [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

Compliance date: [INSERT DATE 180 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

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SUPPLEMENTARY INFORMATION: The Commission is adopting: (1) amendments to 17 CFR 242.600 and 242.606 (respectively, "Rule 600" and "Rule 606" of Regulation NMS) under the Exchange Act to require additional disclosures by broker-dealers to customers about the routing of their orders; (2) amendments to 17 CFR 242.605 ("Rule 605" of Regulation NMS) to require that the public order execution reports be kept publicly available for a period of three years; and (3) conforming changes and updated cross-references in 17 CFR 240.3a51-1(a) ("Rule 3a51-1(a) under the Exchange Act"), 17 CFR 240.13h-1(a)(5) ("Rule 13h-1(a)(5) of Regulation 13D-G"), 17 CFR 242.105(b)(1) ("Rule 105(b)(1) of Regulation M"), 17 CFR 242.201(a) and 242.204(g) ("Rules 201(a) and 204(g) of Regulation SHO"), 17 CFR 242.600(b), 242.602(a)(5) and 242.611(c) ("Rules 600(b), 602(a)(5), and 611(c) of Regulation NMS"), and 17 CFR 242.1000 ("Rule 1000 of Regulation SCI").

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I. Introduction

In July 2016, the Commission proposed to amend Rules 600 and 606 under Regulation NMS to require additional disclosures by broker-dealers to customers about the handling of their orders, to amend Rules 605 and 607 for consistency with the proposed amendments to Rule 606, and to amend other rules to update cross references as appropriate.[1] As discussed below, after careful review and consideration of the comments received, the Commission is adopting these amendments with certain modifications.

Transparency has long been a hallmark of the U.S. securities markets, and the Commission continuously strives to ensure that investors are provided with timely and accurate information needed to make informed investment decisions. In recent years, the Commission and its staff have undertaken a number of reviews of market structure and market events, and much of this effort has aimed to enhance transparency for investors.[2] The amendments being

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[1] See Securities Exchange Act Release No. 78309, 81 FR 49432 (July 27, 2016) ("Proposing Release" or "Proposal").

[2] The Commission recently adopted amendments to Regulation ATS that enhance the operational transparency of alternative trading systems ("ATSs") that transact in National Market System ("NMS")

adopted today to Rule 606 of Regulation NMS represent the Commission's continued commitment to enhance transparency for investors.

Rule 606 encourages competition by enhancing the transparency of broker-dealer order handling and routing practices.[3] Rule 606(a) requires broker-dealers to provide a publicly available quarterly report of information regarding routing of non-directed orders.[4] Rule 606(b) requires broker-dealers to provide customers, upon request, certain information about the routing of their orders. Prior to the amendments being adopted today, the Rule 606(a) requirements applied to smaller dollar-value orders more typical of retail investors but did not apply to large dollar-value orders more typical of institutional investors.[5] As discussed in detail in the Proposing Release, equity market structure, as well as order handling and routing practices, have changed significantly since Rule 606 was adopted in 2000, presenting a need to update the rule

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stocks ("NMS Stock ATSs")." See Securities Exchange Act Release No. 83663 (July 18, 2018), 83 FR 38768 (August 7, 2018) ("ATS-N Adopting Release"). In addition, the Commission has proposed a Transaction Fee Pilot for NMS stocks to help inform the Commission, market participants and the public about the effects, if any, that transaction-based fees and rebates may have on order routing behavior, execution quality, and market quality. See Securities Exchange Act Release No. 82873 (March 14, 2018), 83 FR 13008 (March 26, 2018) ("Transaction Fee Pilot Proposing Release").

3 See Securities Exchange Act Release No. 61358 (January 14, 2010), 75 FR 3594, 3602 (January 21, 2010) ("Concept Release on Equity Market Structure").

4 A "non-directed order" means any customer order other than a directed order. See 17 CFR 242.600(b)(48). A "directed order" means a customer order that the customer specifically instructed the broker-dealer to route to a particular venue for execution. See 17 CFR 242.600(b)(19). As discussed below, these definitions are being revised in connection with the amendments to Rule 606 so that they no longer only apply to "customer orders," but otherwise are remaining the same. See infra Section 0.A.0.0.0.

5 The Commission limited the scope of Rule 606(a) to smaller dollar-value orders by defining a "customer order" to which the rule applied as an order to buy or sell an NMS security that is not for the account of a broker-dealer, but not any order for a quantity of a security having a market value of at least $50,000 for an NMS security that is an option contract and a market value of at least $200,000 for any other NMS security. See 17 CFR 242.600(b)(18).

such that it provides transparency into broker-dealer order handling and routing practices that continues to be useful in today's automated and vastly more complex national market system.[6]

As the Commission noted when it originally adopted Rule 606, in a fragmented market "the order routing decision is critically important" and "must be well-informed and fully subject to competitive forces,"[7] and, further, the public disclosure of order routing practices "could provide more vigorous competition on . . . order routing performance."[8] By updating the Rule 606 disclosure regime, the rule as amended will provide disclosures more relevant to today's marketplace that encourage broker-dealers to provide effective and competitive order handling and routing services, and that improve the ability of their customers to determine the quality of such broker-dealer services.[9]

II. Overview of Adopted Rule Amendments

To facilitate enhanced transparency regarding broker-dealers' handling and routing of orders in NMS stock, the Commission proposed to amend Rules 600(b) and 606 such that all orders of any dollar value in NMS stock[10] submitted by a customer to a broker-dealer would be covered by order handling and routing disclosure rules. Under the proposed amendments, new Rule 606(b)(3) would require broker-dealers to make detailed, customer-specific order handling disclosures for NMS stock orders available to institutional customers in particular, who

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6 See Proposing Release, supra note 1, at 49433-44 for a detailed description of the history and the market developments leading to the Proposal.

7 See Securities Exchange Act Release No. 43590 (November 17, 2000), 65 FR 75414, 75415 (December 1, 2000) ("Rule 606 Predecessor Adopting Release"). For clarity, when this release references "Predecessor Rule 606," it is referring to the version of the rule adopted in the Rule 606 Predecessor Adopting Release.

8 See id. at 75417.

9 If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

10 "NMS stock" and "NMS security" are defined in Rule 600 of Regulation NMS. See 17 CFR 242.600(b)(46)-(47).

previously were not entitled to disclosures under the rule for their order flow, or were entitled to disclosures that have become inadequate in today's highly automated and more complex market.[11] The Commission also proposed to require a broker-dealer to make publicly available a report that aggregates the information required for the detailed customer-specific order handling reports for all NMS stock orders that it receives across all of its customers.[12] Further, the Commission proposed updating Rule 606(a) to provide retail customers in particular with certain enhanced disclosures regarding a broker-dealer's order routing practices.[13]

The Commission received comments on the Proposal.[14] The commenters, many of which also commented on Rule 606 in connection with the Concept Release on Equity Market Structure, overwhelmingly supported updating the disclosures required by Rule 606. Most also expressed support for, or offered constructive critiques of, specific components of the Proposal, and several suggested alternatives to specific provisions of the Proposal, but all comments received recognized a need for enhanced transparency and supported the goals of the Proposal.[15] In addition, the Equity Market Structure Advisory Committee ("EMSAC") provided recommendations with respect to Rules 605 and 606 on November 29, 2016, to provide

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11 See proposed Rule 606(b)(3); see also Proposing Release, supra note 1, at 49447.

12 See proposed Rule 606(c); see also Proposing Release, supra note 1, at 49447.

13 See proposed Rule 606(a); see also Proposing Release, supra note 1, at 49462.

14 Comments received on the Proposal are available on the Commission's website, available at https://www.sec.gov/comments/s7-14-16/s71416.htm.

15 See, e.g., Letter from John A. McCarthy, General Counsel, KCG Holdings, Inc., dated October 31, 2016 ("KCG Letter") at 1; Letter from Joseph Kinahan, Managing Director, Client Advocacy and Market Structure, TD Ameritrade, Inc., dated October 18, 2016 ("Ameritrade Letter") at 1; Letter from Tyler Gellasch, Executive Director, Healthy Markets Association, dated September 26, 2016 ("HMA Letter") at 3-4; Letter from Micah Hauptman, Financial Services Council, Consumer Federation of America, dated September 26, 2016 ("CFA Letter"); Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, Managed Funds Association, dated September 23, 2016 ("MFA Letter") at 1.

meaningful execution quality and order handling disclosures from a retail and an institutional perspective.[16]

After careful review and consideration of the comment letters and upon further consideration by the Commission concerning how to further the goal of more useful and effective disclosure of order handling information under Regulation NMS, the Commission is adopting the proposed amendments to Rules 600 and 606 (and the other corresponding proposed amendments) with certain modifications.[17]

Specifically, the Commission is amending Rule 606(b) of Regulation NMS[18] to require a broker-dealer, upon request of a customer that places, directly or indirectly, one or more orders in NMS stock that are submitted on a "not held" basis with the broker-dealer,[19] to provide customer-specific disclosures, for the prior six months, broken down by calendar month, regarding: (1) its internal handling of such orders; (2) its routing of such orders to various trading centers;[20] (3) the execution of such orders; and (4) the extent to which such orders provided liquidity or removed liquidity, and the average transaction rebates received or fees paid by the broker-dealer.[21] Generally, the information is available upon request by customers who submitted "not held" NMS stock orders through the broker-dealer, and is required to be provided

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16 See EMSAC Recommendations Regarding Modifying Rule 605 and Rule 606 ("EMSAC Rule 606 Recommendations"), November 29, 2016, available at https://www.sec.gov/spotlight/emsac/emsac-recommendations-rules-605-606.pdf.

17 The amendments to Rule 606 would not limit any other obligations that broker-dealers may have under applicable federal securities laws, rules, or regulations, including the anti-fraud provisions of the federal securities laws.

18 17 CFR 242.606(b).

19 Typically, a "not held" order provides the broker-dealer with price and time discretion in handling the order, whereas a broker-dealer must attempt to execute a "held" order immediately.

20 A "trading center" is defined in Rule 600 of Regulation NMS. See 17 CFR 242.600(b)(78).

21 See Rule 606(b)(3).

for each venue and divided into separate sections for directed orders and non-directed orders.[22] This new disclosure requirement is subject to two de minimis exceptions.[23] A "not held" NMS stock order that is subject to either de minimis exception is covered by the existing customer-specific disclosures in Rule 606(b)(1), as is any "held" NMS stock order submitted by a customer to any broker-dealer.[24] For the reasons explained below, the Commission is not adopting the proposed requirement that the Rule 606(b)(3) disclosures be divided into passive, neutral, and aggressive order routing strategies.

In connection with the new disclosure requirement, the Commission is amending Rule 600(b) of Regulation NMS[25] to include definitions of the terms "actionable indication of interest," "orders providing liquidity," and "orders removing liquidity," and to revise the existing definitions of the terms "directed order" and "non-directed order."[26] The Commission is not adopting the proposed defined term "institutional order" in Rule 600(b) and therefore also is not adopting the proposed $200,000 market value threshold for orders to qualify for the new customer-specific disclosures in Rule 606(b)(3).[27]

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22 See id.

23 See Rules 606(b)(4) and (b)(5).

24 See Rule 606(b)(1). As discussed below, while the amendments to Rule 606(b)(1) modify the orders that are covered by Rule 606(b)(1), the required disclosures under Rule 606(b)(1) are not changing. See infra Section 0.A.0.0.0.

25 17 CFR 242.600(b).

26 The newly defined terms are being incorporated into Rule 600(b) in alphabetical order, in keeping with Rule 600(b)'s existing alphabetical organization of the terms defined therein, and the numbered provisions for existing defined terms in Rule 600(b) are being adjusted accordingly. For ease of reference however, throughout this release, citations to pre-existing defined terms in Rule 600(b) are to their pre-existing numbered provisions, unless otherwise indicated.

27 See Rule 606(b)(3); see also infra Section 0.A.1.0.0. Relatedly, the Commission also is not amending Rule 600(b) to rename the term "customer order" as "retail order," as was proposed.

As discussed in Section III.A.7, infra, the Commission is not adopting the proposed amendment to Rule 606 of Regulation NMS to require a broker-dealer to make publicly available, on an aggregate basis, the order handling information required under Rule 606(b)(3).[28]

The Commission is amending Rule 606(a) of Regulation NMS such that the aggregated order routing disclosures that broker-dealers must make publicly available on a quarterly basis pertain to orders of any dollar value in NMS stock that are submitted on a "held" basis. Further, the Commission is making targeted enhancements to these public disclosures to: (1) require limit order information to be split into marketable and non-marketable categories (relatedly, the Commission is adopting a definition of the term "non-marketable limit order" under Rule 600(b));[29] (2) require more detailed disclosure of the net aggregate amount of any payments received from or paid to certain trading centers; (3) require broker-dealers to describe any terms of payment for order flow arrangements and profit-sharing relationships with certain venues that may influence their order routing decisions; and (4) require that broker-dealers keep the order routing reports posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website.[30] In addition to what was proposed, the Commission is replacing the Rule 606(a) requirement to group order routing information for

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28 See proposed Rule 606(c). Because the Commission is not adopting proposed Rule 606(c), pre-existing Rule 606(c), which addresses "Exemptions" from the rule and which the Commission proposed to renumber as Rule 606(d) under the Proposal, is not being renumbered as such and remains unchanged as Rule 606(c).

29 A "marketable limit order" is any buy order with a limit price equal to or greater than the national best offer at the time of order receipt, or any sell order with a limit price equal to or less than the national best bid at the time of order receipt. 17 CFR 242.600(b)(39). "National best bid and national best offer" is defined in Rule 600 of Regulation NMS. 17 CFR 242.600(b)(42). The Commission is adopting new Rule 600(b)(54) to define "non-marketable limit order" to mean "any limit order other than a marketable limit order," as discussed in more detail below. See infra Section 0.0.0.

30 See Rule 606(a); see also Proposing Release, supra note 1, at 49462. "Payment for order flow" has the meaning provided in 17 CFR 240.10b-10. See 17 CFR 242.600(b)(54). A "profit-sharing relationship" is defined in Rule 600 of Regulation NMS. See 17 CFR 242.600(b)(56).

NMS stocks by listing market with a requirement to group such information by stocks included in the S&P 500 Index as of the first day of the quarter and other NMS stocks.

Finally, consistent with the amendments to Rule 606(a), the Commission is amending Rule 605 to require market centers[31] to keep execution reports required by the rule posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website. The Commission also is adopting amendments to other rules to update cross-references in connection with the other rule amendments being adopted today.[32]

Consistent with the Proposal, the Commission continues to believe that generally requiring more detailed, standardized, baseline order handling information to be made available to customers upon request for orders in NMS stocks should enable those customers — and particularly institutional customers — to more effectively assess how their broker-dealers are carrying out their best execution obligations and the impact of their broker-dealers' order routing decisions on the quality of their executions, including the risks of information leakage and potential conflicts of interest.[33] In addition, the Commission believes that these more detailed customer-specific disclosures will further encourage broker-dealers to minimize information leakage,[34] as well as better enable customers to verify that their broker-dealers are following their order handling instructions. Unlike the Proposal and in response to commenters' feedback, the Commission believes that the applicability of these new order routing disclosures should be based on order type ("not held" orders in NMS stocks) rather than the dollar value of an order.

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31 A "market center" means any exchange market maker, OTC market maker, alternative trading system, national securities exchange, or national securities association. See 17 CFR 242.600(b)(38).

32 The Commission is adopting amendments to: Rule 3a51-1(a) under the Exchange Act; Rule 13h-1(a)(5) of Regulation 13D-G; Rule 105(b)(1) of Regulation M; Rules 201(a) and 204(g) of Regulation SHO; Rules 600(b), 602(a)(5), and 611(c) of Regulation NMS; and Rule 1000 of Regulation SCI.

33 See infra Section 0.0; see also Proposing Release, supra note 1, at 49434.

34 See id.

Similar to the Proposal, the Commission believes that simplifying and enhancing the current publicly available disclosures, particularly with respect to financial inducements from trading centers, should assist customers in evaluating better the order routing services of their broker-dealers and how well they manage potential conflicts of interest.[35] Unlike the Proposal and in response to commenters' feedback, the Commission believes that this goal would be targeted more effectively by having these disclosures apply to "held" orders in NMS stocks rather than those under $200,000.

III. Amendments to Rule 600, Rule 605, and Rule 606

Section III discusses in detail the adopted rule amendments. Subsection A addresses the customer-specific order handling disclosures required by new Rule 606(b)(3) and amended Rule 606(b)(1). This section also discusses a part of the Proposal we are not adopting: proposed Rule 606(c)'s requirement that broker-dealers make publicly available an aggregated report of the Rule 606(b)(3) customer-specific order handling information across all of their customers. Subsection B addresses the enhanced public report required under amended Rule 606(a). The newly defined and re-defined terms that the Commission is adopting in Rule 600 in connection with the amendments to Rule 606 are discussed where relevant in subsections A and B. The adopted amendment to Rule 605 is discussed in subsection C.

The staff will review these amendments, including in particular the de minimis exceptions described in Section III.A.1.b.iv below, not later than one year after the compliance date of the amendments, and report to the Commission.

A. Customer-Specific Order Handling Reports

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[35] See Proposing Release, supra note 1, at 49434.

1. Applicability of Customer-Specific Disclosures in Rule 606(b)

a. Proposal

The Commission proposed to delineate the types of orders that would trigger a broker-dealer's obligation to provide a customer with the order handling disclosures required by new Rule 606(b)(3) by amending Rule 600(b) to include a definition of "institutional order."[36] Specifically, the Commission proposed to define an "institutional order" as an order to buy or sell a quantity of an NMS stock having a market value of at least $200,000, provided that such order is not for the account of a broker-dealer.[37] As proposed, Rule 606(b)(3) would apply only to such "institutional orders."

The Commission's proposed definition of "institutional order" dovetailed with the current definition of "customer order,"[38] such that all orders in NMS stocks routed by broker-dealers for their customers, regardless of order dollar value, would be covered by order routing disclosure rules.[39] The Commission's proposed definition maintained a dollar-value threshold analysis to identify the "institutional orders" for which the Rule 606(b)(3) disclosures would be available and distinguish them from "retail orders" that were too small to meet the dollar-value threshold in the definition and for which other disclosures would be available.[40]

The Commission solicited comment on alternatives to a dollar-value threshold approach. For example, the Commission asked commenters among other things: (1) whether dollar value

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36 See proposed Rule 600(b)(31).

37 See id. The proposed definition of institutional order applied only to orders for NMS stocks and, therefore, did not include orders in NMS securities that are options contracts.

38 See supra note 5.

39 See Proposing Release, supra note 1, at 49445. Relatedly, the Commission proposed to rename term "customer order" in Rule 600(b) as "retail order." See infra Section 0.0.1.

40 See id. The Commission preliminarily believed that this would be an effective method of focusing the Rule 606(b)(3) disclosures on orders from institutional customers. See Proposing Release, supra note 1, at 49444-45 for additional detail on the Proposal.

is the proper criterion for defining an institutional order, and (2) whether there are other order characteristics the Commission should consider to distinguish between retail and institutional orders, in addition to, or instead of, a dollar-value threshold.[41]

The Commission also asked whether commenters believe a de minimis exemption from customer-specific reporting under proposed Rule 606(b)(3) is appropriate. Specifically, the Commission asked if commenters believe that the rule should include a de minimis exemption for broker-dealers that receive, in the aggregate, less than a certain threshold number or dollar value of institutional orders.[42] The Commission also asked if the rule should be applicable, with respect to disclosures to any particular customer, only if a broker-dealer receives greater than a certain threshold number or dollar value of institutional orders from that customer.[43]

The Commission received comments on the proposed dollar-value threshold as well as comments in response to its questions regarding a potential de minimis exemption from Rule 606(b)(3) and, after further consideration, is modifying its approach.

b. Final Rule and Response to Comments

i. Comments Regarding Dollar-Value Threshold

The Commission received significant comment on the proposed definition of "institutional order" that criticized the proposed $200,000 threshold as an ineffective proxy for institutional trading interest.[44] Many commenters expressed concern that defining institutional

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41 See id. at 49445.

42 See id. at 49449.

43 See id.

44 See, e.g., Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, The Securities Industry and Financial Markets Association, dated October 17, 2016 ("SIFMA Letter") at 2-3; Letter from Mary Lou Von Kaenel, Managing Director, Financial Information Forum, dated September 26, 2016 ("FIF Letter") at 2-3; Letter from Mary Lou Von Kaenel, Managing Director, Financial Information Forum, dated November 7, 2016 ("FIF Addendum") at 2; Letter from David W. Blass, General Counsel, Investment Company Institute, dated September 26, 2016 ("ICI Letter") at 3-7; Letter from John Russell, Chairman of

order using the proposed $200,000 threshold would be both over-inclusive by including orders from retail investors with a market value over $200,000 and under-inclusive by excluding orders from institutional customers with a market value less than $200,000, and result in the misclassification of a large number of orders.[45] Two commenters stated that they receive retail investor orders that exceed $200,000 in market value.[46]

Several commenters stated that, for reasons such as obtaining a better price, achieving faster execution, avoiding potential information leakage, avoiding market effect, or the advancement in the sophistication of institutional trading systems, many institutional customers, before submitting their order flow to their broker-dealers, internally divide their order flow into smaller "child" orders that may not meet the proposed $200,000 dollar-value threshold.[47] Multiple commenters offered their own analyses of internal and external data indicating that a large percentage of orders from institutional customers would fall below the $200,000

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the Board, and James Toes, President and Chief Executive Officer, Security Traders Association, dated September 26, 2016 ("STA Letter") at 4; HMA Letter at 5-6; Letter from Tyler Gellasch, Executive Director, and Chris Nagy, Director, Healthy Markets Association dated January 6, 2017 ("HMA Letter II") at 2; CFA Letter at 6-7; Letter from Dennis M. Kelleher, President and Chief Executive Officer, Stephen W. Hall, Legal Director and Securities Specialist, and Lev Bagramian, Senior Securities Policy Advisor, Better Markets, Inc., dated September 26, 2016 ("Better Markets Letter") at 5; MFA Letter at 3.

45 See, e.g., Letter from Robert J. McCarthy, Director of Regulatory Policy, Wells Fargo Advisors, LLC, dated September 26, 2016 ("Wells Fargo Letter"); Letter from David M. Weisberger, Managing Director, IHS Markit, dated September 26, 2016 ("Markit Letter"); Letter from Jeff Brown, Senior Vice President, Legislative and Regulatory Affairs, Charles Schwab & Co. Inc., dated September 26, 2016 ("Schwab Letter").

46 See Schwab Letter at 3; Letter from Marc R. Bryant, Senior Vice President and Deputy General Counsel, Fidelity Investments, dated September 26, 2016 ("Fidelity Letter") at 2-3.

47 See Markit Letter at 6-7; Letter from Greg Babyak, Head, Global Regulatory and Policy Group, Bloomberg LP, and Gary Stone, Market Structure Strategy, Bloomberg Tradebook and Bloomberg LP, dated September 26, 2016 ("Bloomberg Letter") at 11; Letter from Erin K. Preston, Chief Compliance Officer and Associate General Counsel, Dash Financial LLC, dated September 26, 2016 ("Dash Letter") at 3; Letter from Richard Foster, Senior Vice President and Senior Counsel for Regulatory and Legal Affairs, Financial Services Roundtable, dated September 26, 2016 ("FSR Letter") at 3-4; MFA Letter at 3; FIF Letter at 3; FIF Addendum at 2; Letter from Nathaniel N. Evarts, State Street Global Advisors, dated September 26, 2016 ("SSGA Letter") at 1.

threshold.[48] One of these commenters stated that the proposed definition of institutional order could exclude disproportionately more orders of smaller funds, orders in less liquid stocks that fall below the $200,000 threshold, and larger orders that are broken up into smaller child orders by institutional customers.[49]

One commenter expressed concern that the dollar-value threshold would exclude the majority of orders from institutions from the enhanced institutional order handling disclosure requirements, diminishing the value of the disclosure and forcing institutional investors to continue individual negotiations to obtain order handling information.[50] Another commenter stated that excluding an unknown portion of a large institution's orders (and perhaps all of a smaller institution's orders) from heightened scrutiny may create opportunities for abuse and evasion, and that investors may therefore seek to deliberately avoid identifying their orders as institutional orders.[51] Another commenter stated that different securities trade differently based on available liquidity and their capacity to move the market.[52] The commenter stated that the proposed definition may force customers to choose between placing orders above the threshold to receive disclosures but at the risk of higher market impact costs or staying below the threshold to protect order information but sacrificing their right to disclosures.[53]

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48 See Markit Letter at 6-7; Letter from Matt D. Lyons, Global Trading Manager, The Capital Group of Companies, Timothy J. Stark, Market and Transactional Research, The Capital Group of Companies, and Michael J. Triessl, Senior Vice President and Senior Counsel, Capital Research and Management Company, dated September 30, 2016 ("Capital Group Letter") at 2; Bloomberg Letter at 11-12.

49 See Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel Securities, dated October 13, 2016 ("Citadel Letter") at 2.

50 See ICI Letter at 3.

51 See HMA Letter at 6.

52 See CFA Letter at 7.

53 See id.

As illustrated by these comments, there was broad opposition to the $200,000 dollar-value threshold in the proposed definition of institutional order. The Commission is not adopting the proposed definition. Rather than attempt to capture within a definition of "institutional order" the orders that account for most institutional order dollar volume, the comments indicate that market participants would prefer a different approach to order handling disclosures.[54] In light of these comments, the Commission believes that a modified approach to delineating the orders covered by new Rule 606(b)(3) would be more consistent with the expectations of market participants.

ii. Commenter Recommendations Regarding a Modified Approach

Many commenters urged the Commission to replace the proposed dollar-value threshold with a different approach for identifying the orders covered by the new customer-specific order routing disclosures.[55] They generally supported two different approaches: a number of commenters suggested that the applicability of the new order routing disclosures be based on order type ("held" versus "not held" orders);[56] and a number of other commenters suggested that

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54 See, e.g., ICI Letter at 3, 6-7 (noting that adopting a definition of institutional order that would apply to all orders, regardless of size, that an institutional customer submits to its broker-dealer would best enable the Commission to accomplish the objective of providing information necessary for institutional investors to understand broker-dealers' order routing decisions); Letter from Amy B.R. Lancellotta, Managing Director, Independent Directors Council, dated September 26, 2016 ("IDC Letter") at 2 (supporting ICI's recommendation); Capital Group Letter at 2-3; HMA Letter II (agreeing with Capital Group, and noting that covering all institutional orders is one of the most important aspects of the rule).

55 See, e.g., MFA Letter at 3-4; CFA Letter at 6-8; FIF Letter at 2-3, 14-15; ICI Letter at 3, 6-7; STA Letter at 3-4; SIFMA Letter at 1-3; FIF Addendum at 2; Healthy Markets Letter at 2; Jon Schneider, Chairman of the Board, and James Toes, President and Chief Executive Officer, Security Traders Association, dated April 11, 2017 ("STA Letter II") at 2.

56 See, e.g., SIFMA Letter at 3; Bloomberg Letter at 12; Citadel Letter at 2-3; FIF Letter at 2-3, 14-15; FIF Addendum at 2; STA Letter II at 2. See also EMSAC Rule 606 Recommendations, supra note 16.

their applicability be based on the characteristics (e.g., type or regulatory status) of the entity placing the order.[57]

Commenters who supported an order type-based approach suggested that the not held order type classification would be an effective proxy for identifying orders typical of institutional investors for which the existing customer-specific disclosures are inapplicable or inadequate because institutional investor orders are generally not held to the market.[58] Commenters attributed this to the fact that a broker-dealer has time and price discretion in executing a not held order, and institutional investors in particular rely on such discretion for reasons such as minimizing price impact, whereas a broker-dealer must attempt to execute a held order immediately, which typically better suits retail investors who seek immediate executions and rely less on broker-dealer order handling discretion.[59] As one commenter put it, the Rule 606(b) disclosure requirements should be based on whether the broker-dealer has discretion when handling the client's order and, as a general matter, broker-dealers have no discretion in handling retail investor held orders but do have discretion in handling institutional investor not held orders.[60] One commenter also stated that the held/not held approach would provide a targeted, deterministic solution to the issues presented by the proposed order dollar-value-based

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57 See SSGA Letter at 1; ICI Letter at 3, 6-7; IDC Letter at 2; MFA Letter at 3; Fidelity Letter at 3; CFA Letter at 8; Better Markets Letter at 5.

58 See Ameritrade Letter at 2; Letter from Richie Prager, Senior Managing Director, Head of Trading, Liquidity and Investments Platform, Hubert De Jesus, Managing Director, Co-Head of Market Structure and Electronic Trading, Supurna VedBrat, Managing Director, Co-Head of Market Structure and Electronic Trading, and Joanne Medero, Managing Director, Government Relations and Public Policy, BlackRock, Inc., dated September 26, 2016 ("BlackRock Letter") at 2; Citadel Letter at 2-3; Markit Letter at 4; Schwab Letter at 3; Capital Group Letter at 2-3; KCG Letter at 4; FIF Letter at 2-3; FIF Addendum at 2; STA Letter II at 2. One commenter noted its belief that the vast majority of orders entered by institutional customers are with not-held instructions and the vast majority of orders entered by retail investors are with held instructions. See STA Letter at 4.

59 See Wells Fargo Letter at 5; Markit Letter at 3 n.7; Capital Group Letter at 3; Schwab Letter at 3; Ameritrade Letter at 2 n.2; KCG Letter at 4; FIF Addendum at 2.

60 See SIFMA Letter at 3; see also Capital Group Letter at 2; KCG Letter at 4.

distinction between retail and institutional orders, and would alleviate the need to identify certain orders as institutional and others as retail for purposes of order routing disclosure.[61]

Several commenters also stated that basing the Rule 606(b) disclosure requirements on whether an order is held or not held would be straightforward and minimally burdensome because: broker-dealers and other market participants are very familiar with these order type classifications; classifying orders as held or not held would be consistent with current industry practice; and the terms held and not held are common terms of usage in the securities markets.[62] One of these commenters stated that broker-dealers already must mark orders that they execute as held or not held,[63] and another commenter stated that the held/not held order classifications are commonly recognized in the FIX Protocol.[64] Two commenters pointed out that the held and not held order classifications are already utilized in the Commission's definition of "covered order" in Rule 600(b)(15).[65] One of these commenters stated that not held orders are generally distinguished from held orders in regulations and firms' monitoring processes, and specifically noted that broker-dealers already characterize orders on a held or not held basis to comply with Rule 605's covered order requirement, OATS technical specifications, and other rules such as FINRA Rule 5320.[66]

Two commenters objected to the held or not held analysis and stated that the applicability of the new customer-specific disclosures should not be based on order type because the held/not

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61 See FIF Letter at 2-3, 14-15.

62 See Citadel Letter at 3; Markit Letter at 3, 7-8; KCG Letter at 4; Capital Group Letter at 2-3; SIFMA Letter at 3.

63 See Capital Group Letter at 3.

64 See Citadel Letter at 3.

65 See SIFMA Letter at 3 and n. 4; Market Letter at 3 and n. 8.

66 See Markit Letter at 3-4, 7.

held classification is within the control of the order sender.[67] One commenter stated that the held/not held order type-based distinction is an imprecise proxy for the status of the underlying customer, would not cover all institutional orders, and that the distinction may leave out many smaller investment advisers that currently trade through or have some portion of assets under management through "retail" channels.[68] This commenter also stated that the distinction would allow for potential gaming, and that amidst rising concerns with broker-dealers' conflicts of interests, some institutional investors have increasingly come to use held orders.[69] Another commenter, however, understood that some not held orders may come from retail customers, and that institutional clients may send broker-dealers a small amount of held orders, but nevertheless supported scoping the disclosures by the held and not held order classifications.[70]

Some commenters suggested that the applicability of the customer-specific disclosures should be based on the type of the entity placing the order.[71] One commenter argued that this approach would be preferable to an approach based on order type classification because broker-dealers already must know whether their customers are institutional investors.[72] Another commenter stated that orders should not be classified according to the unique order handling typical of an entity, as that characteristic may change over time, whereas the entity type itself remains constant.[73]

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67 See HMA Letter at 7; Dash Letter at 4.

68 See HMA Letter II at 2-3.

69 See id.

70 See SIFMA Letter at 3; see also Markit Letter at 7-8; Schwab Letter at 3; Letter from Manisha Kimmel, Chief Regulatory Officer, Wealth Management, Thomson Reuters, dated September 26, 2016 ("Thomson Reuters Letter") at 1; Citadel Letter at 3.

71 See, e.g., ICI Letter at 6-7; MFA Letter at 3; Fidelity Letter at 3; STA Letter at 4; CFA Letter at 8.

72 See HMA Letter II at 2.

73 See Better Markets Letter at 5.

Most of the commenters that supported an entity-centric approach suggested that the Commission rely on FINRA Rule 4512(c), which defines the term "institutional account" for purposes of that rule, as a source for such an approach.[74] Two commenters also suggested as a source FINRA Rule 2210(a)(4), which defines the term "institutional investor" for purposes of that rule, and also incorporates the definition of "institutional account" from FINRA Rule 4512(c).[75] One commenter stated that, because all broker-dealers that handle customer orders for equity securities are FINRA members, they should be accustomed to using the standards supplied in FINRA's rules.[76]

Some commenters offered additional considerations or recommendations regarding how an entity-based approach should be crafted. For example, one commenter suggested that the new customer-specific disclosures should apply to any order attributed to any entity that is a "large trader" under Section 13(h) of the Exchange Act.[77] Another commenter stated that institutional and retail investors should be defined according to whether the investor is an entity or individual.[78]

In addition to the foregoing commenter recommendations, a few commenters suggested that there should be no distinction between retail and institutional customers for purposes of the

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74 See ICI Letter at 6-7 n.19; MFA Letter at 3-4; Fidelity Letter at 3; STA Letter at 4; CFA Letter at 8; Bloomberg Letter at 13; see also FIF Letter at 3.

75 See MFA Letter at 3-4; ICI Letter at 6-7 n.19.

76 See ICI Letter at 6-7 and n.19; see also CFA Letter at 8.

77 See SSGA Letter at 1; see also 15 U.S.C. 78m(h). Another commenter expressed concern that a large trader-based definition of institutional order would result in considerable overlap among retail customers that also are large traders under Rule 13h-1. See STA Letter at 4. This is one of several examples of commenters critiquing or supporting the views expressed by other commenters regarding the definition of institutional order. See, e.g., IDC Letter at 2 (supporting ICI Letter's recommendations on how to expand the definition of "institutional" order); STA Letter at 4 (supporting remarks made in FIF Letter); Citadel Letter at 3 (noting support for similar proposal from Blackrock Letter and ICI Letter); Ameritrade Letter at 2 (noting commenter support for defining institutional orders by the type of order submitted); HMA Letter II at 2-3 (noting broad commenter support for not defining institutional orders by dollar size).

78 See Better Markets Letter at 5.

new Rule 606(b)(3) order handling reports and that all orders should be covered by the Rule 606(b)(3) reports,[79] or that retail and institutional customers should receive the same disclosures.[80] One commenter stated that the goal with respect to both retail investor and large institutional orders should be best execution.[81]

iii. The Commission's Adopted Approach

The Commission is not adopting a definition of "institutional order" or an order dollar value-based approach to delineate the applicability of new Rule 606(b)(3).[82] Generally, the amendments to Rule 606(b) are designed to apply required order handling disclosures to any NMS stock order regardless of its dollar value and to require more detailed disclosures regarding how broker-dealers exercise discretion when handling and routing customers' NMS stock orders in today's electronic markets. These disclosures are designed to provide transparency to customers for whom the existing customer-specific disclosures under Rule 606(b) are inapplicable or have become inadequate. Upon further consideration and in light of the views expressed by commenters, the Commission believes that these goals can best be accomplished if the detailed, customer-specific, order handling disclosures set forth in Rule 606(b)(3) generally apply to orders of any dollar value for NMS stock that customers submit to their broker-dealers on a "not held" basis. Accordingly, under Rule 606(b)(3), a broker-dealer must provide the disclosures set forth therein, upon customer request, to any customer that places, directly or

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79 See HMA Letter at 5; Dash Letter at 3; HMA Letter II at 1-2; Letter from Abraham Kohen, President, AK Financial Engineering Consultants, LLC, dated September 28, 2016 ("Kohen Letter").

80 See, e.g., Better Markets Letter at 5-7.

81 See HMA Letter at 5.

82 Relatedly, as discussed below, the Commission is not renaming the term "customer order" as "retail order" in Rule 600(b). See infra Section 0.0.0.

indirectly, one or more orders in NMS stock that are submitted on a not held basis with the broker-dealer, subject to two de minimis exceptions discussed below.[83]

We believe that basing the applicability of this requirement on whether orders are held or not held serves the purposes of the disclosures. A broker-dealer must attempt to execute a held order immediately; a not held order instead provides the broker-dealer with price and time discretion in handling the order. As a result, the Rule 606(b)(3) disclosures apply to NMS stock orders for which customers have provided their broker-dealers with price and time order handling discretion, and do not apply to orders that the broker-dealer must attempt to execute immediately. The Commission believes that since the disclosures are designed to provide greater transparency into a broker-dealer's exercise of order handling discretion, they should be provided for orders for which broker-dealers actually exercise such discretion. Focusing the customer-specific report in this way will better enable customers to understand their broker-dealers' order routing decisions and the extent to which those decisions may be affected by conflicts of interest or create information leakage. Customers also will be better able to assess their broker-dealers' skill and effectiveness in handling their orders and achieving satisfactory executions.

Importantly, as noted by multiple commenters, broker-dealers and other market participants are familiar with the held and not held order type classifications, classifying orders

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83 See infra Section 0.A.1.0.0; see also Rule 606(b)(3). Consistent with what was proposed, Rule 606(b)(3) applies only to orders for NMS stocks and does not include orders in NMS securities that are options contracts. Some commenters supported this approach. See STA Letter II at 2-3; FIF Letter at 12. Other commenters recommended that options be included in the amended order handling disclosures being adopted today. See Dash Letter at 1-2; HMA Letter at 12; Markit Letter at 14. The Commission continues to believe that, as noted in the Proposing Release, due to differences in the current market structure for NMS securities that are options contracts – in particular the lack of an over-the-counter market in listed options – the same market structure complexities that exist for NMS stocks do not exist at this time for NMS securities that are options contracts to a degree that warrants the more detailed order handling disclosures proposed herein. See Proposing Release, supra note 1, at 49444 n.101.

as held or not held would be consistent with current industry practice, and the terms "held" and "not held" are common terms of usage in the securities markets.[84] Indeed, broker-dealers already utilize the "held" and "not held" order classifications to comply with FINRA OATS technical specifications,[85] and existing Commission rules, such as the definition of "covered order" in Rule 600(b), rely on market participants' ability to distinguish between "held" and "not held" orders. As such, the Commission is not adding definitions of these terms to Rule 600(b). The Commission intends for broker-dealers to rely on their current methods for classifying orders as "held" or "not held" for purposes of complying with Rule 606. By leveraging the established not held order classification, Rule 606(b)(3)'s applicability should be easily understood by market participants and the implementation burdens broker-dealers encounter in order to comply with Rule 606(b)(3) should be lessened to the extent that their order handling and routing systems are already configured for not held order classifications.

Further, under the Commission's adopted approach, any customer is entitled to receive the Rule 606(b)(3) disclosures for their not held NMS stock orders, subject to two de minimis exceptions. The Commission is not adopting definitions of "institutional order" or "retail order," and the adopted amendments make no such distinction, based on dollar value of the order or otherwise. In this regard, the Commission's adopted approach is consistent with comments that stated that no such distinction is necessary. Under final Rule 606(b)(3), customers may request the disclosures for any not held NMS stock orders that they submit (subject to the de minimis exceptions, discussed below), including not held NMS stock orders for less than $200,000 in

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84 See Citadel Letter at 3; Markit Letter at 3, 7-8; KCG Letter at 4; Capital Group Letter at 2-3; SIFMA Letter at 3.

85 See FINRA OATS Reporting Technical Specifications, September 12, 2016, at pp. 4-2 to 4-3, available at http://www.finra.org/sites/default/files/TechSpec_9122016.pdf.

market value, which would have been defined as "retail orders" and not subject to the Rule 606(b)(3) disclosures under the Proposal. The Commission believes it is appropriate to make the Rule 606(b)(3) disclosures available for all not held NMS stock orders (subject to the de minimis exceptions) so customers have information sufficient to evaluate the broker-dealers that are exercising order handling and routing discretion.

The Commission believes that it is appropriate for broker-dealers to provide the Rule 606(b)(3) disclosures to those customers for whom the existing customer-specific order routing disclosures in Rule 606(b) are inapplicable or inadequate. Specifically, the Rule 606(b)(3) disclosures are particularly suited to customers that submit not held NMS stock orders because the disclosures set forth detailed order handling information that is useful in evaluating how broker-dealers exercise the discretion attendant to not held orders and, in the process, carry out their best execution obligations and manage the potential for information leakage and conflicts of interest. Moreover, many of the commenters that criticized the Commission's proposed definition of institutional order suggested that all or nearly all of an institutional customer's orders should be covered by the Rule 606(b)(3) disclosures regardless of order dollar value. Some of these commenters supported accomplishing this via an entity-based approach to Rule 606(b)(3)'s applicability,[86] which the Commission has not chosen to adopt for reasons set forth below, and some of these commenters supported the adopted approach.[87] By using the not held order distinction rather than the proposed $200,000 threshold, Rule 606(b)(3) as adopted will cover more order flow than would have been covered under the Proposal.[88] In addition, by using the not held order distinction, Rule 606(b)(3) as adopted will likely result in more Rule 606(b)(3)

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86 See supra note 58.

87 See supra note 56.

88 See infra Section 0.0.0.0.0.0.

disclosures for order flow that is typically characteristic of institutional customers — not retail customers — and will likely cover all or nearly all of the institutional order flow.

While some commenters suggested that the new customer-specific disclosures in Rule 606(b)(3) should be available to all orders without any limitation based on entity type or order classification or otherwise, the Commission believes that it is appropriate to differentiate between not held orders and held orders for purposes of order handling information disclosure because broker-dealers generally handle not held orders differently from held orders due to the discretion they are afforded with not held orders but not with held orders.[89] As a result, the information pertinent to understanding broker-dealers' order handling practices for not held orders is not the same as for held orders.

Indeed, in recent years, routing and execution practices for not held orders have become more automated, dispersed, and complex.[90] In today's electronic markets, broker-dealers' commonly handle such orders by using sophisticated institutional order execution algorithms and smart order routing systems that decide the timing, pricing, and quantity of orders routed to a number of various trading centers, and that may divide a large "parent" order into many smaller "child" orders, and route the child orders over time to different trading centers in accordance with a particular strategy.[91] The order handling disclosures required by Rule 606(b)(3) are designed to take this into account and provide relevant disclosures that, in the Commission's view, will enable customers to better assess their broker-dealers' order execution quality and order handling ability overall and methods for complying with best execution obligations, as well

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89 See, e.g., Schwab Letter at 3.

90 See supra Section 0; see also Proposing Release, supra note 1, at 49436.

91 See id.

as, more specifically, the degree to which their broker-dealers' order routing practices may involve information leakage or the potential for conflicts of interest.

By contrast, the Commission's concern regarding how broker-dealers handle held orders is less about the difficulties posed by more automated, dispersed and complex order routing and execution practices. Rather, the Commission believes that enhanced disclosures for held orders should provide customers with more detailed information including with respect to the financial inducements that trading centers may provide to broker-dealers to attract immediately executable trading interest, as opposed to the different information geared towards not held NMS stock orders that is set forth in Rule 606(b)(3). As noted above and discussed below, the quarterly public disclosures required under Rule 606(a) are indeed being enhanced to provide more detail regarding financial inducements to broker-dealers, and the Commission believes that these disclosures are more appropriately tailored to the characteristics of held order flow and the needs of customers that use held orders.[92]

Also, the Commission does not disagree with one commenter's statement that best execution should be the goal for orders from both institutional customers and retail investors, and that both types of investors deserve to know how their orders are routed and executed.[93] Best execution is the broker-dealer's legal obligation for all orders, whether from retail or institutional customers.[94] While meeting their best execution obligations, broker-dealers frequently may choose to handle orders in a variety of different ways and choose among a host of available order

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92 As noted supra and infra, the Commission is also is amending Rule 606(a) such that it applies to held orders of any size in NMS stock.

93 See HMA Letter at 5.

94 See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37538 (June 29, 2005) ("Regulation NMS Adopting Release"). FINRA has codified a duty of best execution into its rules. See FINRA Rule 5310.

routing destinations. Because the choices broker-dealers make in this regard are informed by the type of order at hand, for the reasons stated above, the Commission believes that separate disclosures for not held orders and held orders are the better way to help customers understand how their broker-dealers are handling and routing their orders and how well their broker-dealers are performing these functions. While this commenter also stated that the Proposal's reforms for retail customers are inadequate, for the reasons stated above, as well as in Section III.B infra, the Commission disagrees.

As noted above, other commenters suggested basing Rule 606(b)(3)'s applicability on the characteristics of the customer that submits the order to the broker-dealer. This entity-centric approach suggested by commenters would require the Commission to set forth the types of customers that may request the Rule 606(b)(3) disclosures for their NMS stock orders, but would not entail any differentiation in the types of orders covered by Rule 606(b)(3). As a result, NMS stock orders from qualifying customers that are submitted on a held basis would be covered by the Rule 606(b)(3) disclosures. This is a sub-optimal outcome. Broker-dealers must attempt to execute held orders immediately and are afforded no discretion in handling them; therefore, applying the Rule 606(b)(3) disclosures to held orders would not provide insight into how a broker-dealer exercises order handling and routing discretion. Moreover, including a customer's held orders in the Rule 606(b)(3) report could obfuscate the reports' depiction of the discretion actually exercised by the broker-dealer with respect to not held orders and undermine the very purpose of these disclosures.

An entity-based approach also would require the Commission to prescribe institutional status criteria that customers must fit in order to be entitled to receive the disclosures. A risk with such an approach is that the criteria could be over-inclusive or under-inclusive. The

Commission is particularly concerned about potential under-inclusiveness because customers that do not fit the criteria would not be entitled to receive the disclosures. To mitigate this risk, the Commission, as suggested by commenters, could leverage certain existing rules that already set forth institutional status criteria. For example, several commenters suggested as sources the definitions of "institutional account" and "institutional investor" in FINRA Rules 2210(a)(4) and 4512(c), respectively.[95] But these definitions serve a purpose for the noted FINRA rules that is different from the purpose similar prescribed criteria would serve for the purpose of Rule 606(b)(3). Under FINRA Rule 4512, a broker-dealer is not required to obtain for "institutional accounts" certain additional information that it is required to obtain for accounts that are not "institutional accounts."[96] Likewise, under FINRA Rule 2210(a)(4), a broker-dealer is subject to less prescriptive review requirements for "institutional communications" that are solely to "institutional investors" than it is subject to for other, "retail communications."[97] Under both of these FINRA rules, exclusion from the defined "institutional" criteria triggers a more stringent due diligence or review obligation for the broker-dealer. The opposite would be true under an entity-centric approach to Rule 606(b) — if the institutional status criteria adopted by the Commission were not met, the market participant would be excluded from the more detailed disclosure regime.[98]

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95 See supra notes 74 and 75 and accompanying text.

96 See FINRA Rule 4512(a)(2).

97 See FINRA Rule 2210.

98 One commenter suggested that the "large trader" designation under Section 13(h) of the Exchange Act serve as the source for the Commission's institutional status criteria (see SSGA Letter at 1, supra note 77). This approach would, however, include held orders from large traders within the required disclosures. Moreover, to qualify as a large trader under Rule 13h-1, a person must meet daily or monthly aggregate share volume or market value thresholds for transactions in NMS securities. See 17 CFR 242013h-1. Therefore, such an approach would exclude orders from an institutional customer that does not meet the designated thresholds. In addition, because the large trader definition is based on transactions in NMS securities, it takes into account transactions in option contracts that are NMS securities whereas the

This categorical exclusion of some customer types from Rule 606(b)(3)'s purview is avoided under the Commission's adopted approach. By basing the application of Rule 606(b)(3) on the held and not held order classifications, no customer is categorically excluded from receiving the Rule 606(b)(3) disclosures. The Commission acknowledges that some commenters stated that an entity-centric approach to Rule 606(b)(3)'s coverage based on the noted FINRA rules would coincide with familiar industry standards regarding the types of market participants that are considered to be "institutional."[99] But adapting the FINRA rules for the Commission's purposes in Rule 606(b) would present challenges. For example, private funds such as hedge funds may not be covered by the "institutional" definitions in FINRA Rules 2210 or 4512,[100] yet in the Proposing Release the Commission noted, by way of example, that "[a]n institutional customer includes … hedge funds," among others.[101] If the Commission relied solely on the FINRA rules, contrary to the Commission's contemplation in the Proposing Release, hedge funds may not be defined as "institutional" for Rule 606(b) purposes and would not be entitled to

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Commission's amendments to Rule 606(b) apply only to orders for NMS stock. Another commenter stated that institutional and retail investors should be defined according to whether the investor is an entity or individual (see Better Markets Letter at 5, supra note 78). This approach similarly would include held orders within the Rule 606(b)(3) disclosures. Further, certain natural persons may take on the characteristics of institutions in their trading behavior and utilize not held orders to a significant degree, but they would be categorically excluded from receiving the Rule 606(b)(3) disclosures for such orders under an approach based on an individual versus entity distinction.

99 See HMA Letter II at 2; CFA Letter at 8; STA Letter at 4.

100 FINRA Rule 4512(c)(3) contains a catch-all provision that includes within the definition of "institutional account" the account of any person with at least $50 million in total assets. An entity that is not otherwise expressly covered by FINRA Rule 4512(c)(1) or (2), such as a hedge fund for example, is not covered by the definition if it has total assets of less than $50 million. As such, if the Commission were to rely on the FINRA rules as suggested by some commenters, smaller entities with less than $50 million in total assets may be excluded from Rule 606(b)(3) even though they may have less bargaining power than their larger competitors and therefore may benefit most from required, standardized order routing disclosures. There also could be disparate results – for example, a registered investment company with less than $50 million in assets would be covered because it is expressly identified in the rule, while a hedge fund with less than $50 million in assets would not be covered.

101 See Proposing Release, supra note 1, at 49433, n.1.

the more detailed Rule 606(b)(3) disclosures. Of course, the Commission could modify the criteria used in the FINRA rules to better suit its purposes here, but even then there would still be a risk of under-inclusiveness in the adapted criteria. There also could be new types of market participants that evolve and that trade in an institutional manner, but if they were not covered by the Commission's prescribed institutional status criteria, they would not be entitled to receive the Rule 606(b)(3) disclosures under the rule.

Moreover, as noted above, commenters also highlighted the industry familiarity with the not held order classification.[102] And, unlike the "institutional" definitions in the referenced FINRA rules, which apply in contexts completely different from broker-dealer order handling, the not held order classification is already used by broker-dealers specifically for order handling purposes, among other things. For example, FINRA Rule 7440 requires broker-dealers to record certain information, including any "special handling requests," when an order is received, originated, or transmitted.[103] FINRA's OATS Reporting Technical Specifications state that, when a FINRA member originates or receives an order and then subsequently transmits that order to another desk or department within the firm, the member is required to record and report to OATS, among other things, "special handling instructions that are communicated by the receiving department to a desk or other department, such as 'Not Held.'"[104]

Basing the applicability of Rule 606(b)(3) on customers' not held NMS stock orders is, in the Commission's view, the most tailored approach to aligning the orders covered by Rule 606(b)(3) with the Commission's intent for the rule to provide more detailed disclosure and

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102 See Citadel Letter at 3; Markit Letter at 3, 7-8; KCG Letter at 4; Capital Group Letter at 2-3; SIFMA Letter at 3.

103 See FINRA Rule 7440(b)(15) and (c)(1)(G).

104 See FINRA OATS Reporting Technical Specifications, September 12, 2016, at pp. 4-2 to 4-3, available at http://www.finra.org/sites/default/files/TechSpec_9122016.pdf.

enhanced transparency regarding how broker-dealers handle NMS stock orders, and to provide such transparency to customers for whose NMS stock orders the current disclosure regime is inapplicable or inadequate. This approach also is likely to avoid the problems inherent in an entity-centric approach. Further, many commenters, as well as EMSAC, supported basing Rule 606(b)(3)'s application on the not held order classification. Accordingly, under Rule 606(b)(3), a broker-dealer must provide the disclosures set forth therein, upon customer request, to any customer that places, directly or indirectly, one or more orders in NMS stock that are submitted on a not held basis with the broker-dealer, subject to the de minimis exceptions discussed below.

iv. De Minimis Exceptions

The Commission is adopting in new Rules 606(b)(4) and (b)(5) two de minimis exceptions from Rule 606(b)(3)'s requirements, either of which excepts a broker-dealer from the Rule 606(b)(3) requirements. One of the exceptions focuses on the broker-dealer firm and the other focuses on the individual customer. Specifically, a broker-dealer is not obligated to provide the Rule 606(b)(3) report: (i) to any customer if not held NMS stock orders constitute less than 5% of the total shares of NMS stock orders that the broker-dealer receives from its customers over the prior six months,[105] or (ii) to a particular customer if that customer trades through the broker-dealer, on average each month for the prior six months, less than $1,000,000 of notional value of not held orders in NMS stock.[106] These de minimis exceptions are designed such that the Rule 606(b)(3) requirements apply when a broker-dealer's order flow consists primarily of not held orders for NMS stock and when a customer's trading profile is such that it

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105 See Rule 606(b)(4). Under the rule, the first time a broker-dealer meets or exceeds the 5% threshold, it has a grace period of up to three calendar months to provide the Rule 606(b)(3) report. There is no such grace period for compliance after the first time the threshold is met or exceeded. See id.

106 See Rule 606(b)(5). As discussed below, however, when either de minimis exception applies, the broker-dealer still must provide, if requested, the Rule 606(b)(1) customer-specific disclosures for not held NMS stock orders that it receives from customers. See infra Section 0.A.1.0.0.

relies heavily on the discretion of the broker-dealer and so would sufficiently benefit from the Rule 606(b)(3) disclosures.

The Commission received several comments in response to its questions regarding a potential de minimis exception from customer-specific reporting under proposed Rule 606(b)(3). Multiple commenters supported an exception from Rule 606(b)(3) reporting for broker-dealers that have either a de minimis level of institutional customers or a de minimis amount of institutional trading activity as measured by executed shares as a percentage of all executed shares.[107] These commenters also supported disclosure based on whether an order is held or not held and generally discussed the reasoning for a de minimis exception in that context.[108] Commenters also suggested that firms that receive less than 5% of orders from institutions should be exempt from requirements to provide disclosures for institutional orders, both at the individual investor level and in the aggregate.[109] One commenter stated that the de minimis threshold should be set at 5% of not held orders received.[110] Two commenters noted that there currently is a 5% threshold in Rule 606(a) in connection with the rule's requirement that broker-dealers disclose the identity of any venue to which 5% or more of non-directed orders were routed for execution.[111] One of these commenters stated that the purpose of a de minimis

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107 See, e.g., FIF Letter at 5, 10; STA Letter at 6; Citadel Letter at 3.

108 See, e.g., FIF Letter at 5, 10; STA Letter II at 2; Citadel Letter at 3; Thomson Reuters Letter at 1; Ameritrade Letter at 2.

109 See STA Letter II at 2; Ameritrade Letter at 2; Wells Fargo Letter at 5. See also Letter from Jeff Brown, Senior Vice President, Legislative and Regulatory Affairs, Charles Schwab & Co. Inc., dated October 30, 2018 ("Schwab Letter II").

110 See Schwab Letter II at 2.

111 See Ameritrade Letter at 2; Wells Fargo Letter at 5.

exception is to provide relief so that reporting obligations for a given entity more closely match its actual core business and targeted customer profile.[112]

Some commenters stated that the costs incurred by retail broker-dealers to create systems to generate the Rule 606(b)(3) reports would exceed any benefits.[113] One of these commenters stated that the Rule 606(b)(3) statistics are not relevant to retail-oriented brokers' customer base and would provide them no added benefit, and that requiring retail broker-dealers to generate the statistics would be an onerous task with significant added expense.[114] Two commenters recommended an exemption from Rule 606(b)(3) reporting for firms with a de minimis amount of not held order flow in light of the fact that retail customers occasionally submit not held orders.[115] One commenter believed that, if broker-dealers with a de minimis amount of not held orders are exempted, the majority of the exemptions would be for retail brokers.[116]

Other commenters did not support a de minimis exception even if a broker-dealer has limited institutional customer order flow, so that institutional customers can compare order routing among all broker-dealers.[117] One commenter stated that, if a small broker-dealer is able to effectively manage orders from institutional customers in the current complex market

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112 See Wells Fargo Letter at 5. See also Letter from Stephen John Berger, Managing Director, Government and Regulatory Policy, Citadel Securities, dated October 23, 2018 ("Citadel Letter II") at 1-2 (noting that the 5% threshold suggested by other commenters should ensure that smaller broker dealers are not adversely affected by the new disclosure requirement, and noting that a threshold based on a percentage of orders or shares received could potentially be set lower than a threshold based on a percentage of executed shares).

113 See Ameritrade Letter at 2; Citadel Letter at 3; FIF Letter at 5, 10.

114 See FIF Letter at 5. See also Markit Letter at 17.

115 See Thomson Reuters Letter at 1; Schwab Letter at 3.

116 See STA Letter at 8-9.

117 See, e.g., Bloomberg Letter at 15; MFA Letter at 4-5. See also Markit Letter at 28.

environment, it should be able to provide customers with information on their order routing practices.[118]

The Commission believes that a de minimis exception from Rule 606(b)(3) reporting, as set forth in Rule 606(b)(4), presents advantages for certain broker-dealers. Broker-dealers handle different types of order flow, and not all broker-dealers handle a significant amount of not held NMS stock order flow. Indeed, some broker-dealers focus mainly on servicing customers that use held orders in NMS stock, and as such, typically do not handle not held order flow in NMS stock. The Commission believes that it is appropriate to relieve broker-dealers with minimal or zero not held order flow from the obligation to incur the costs associated with having the capability to provide the new Rule 606(b)(3) disclosures for not held NMS stock orders. The Commission does not believe that it would be appropriate to require every broker-dealer, regardless of its customer base and core business, to be compelled to incur the costs required to create the systems and processes necessary to generate the Rule 606(b)(3) reports. The Commission does not intend to introduce a wholesale change in order handling and routing disclosure requirements such that broker-dealers whose order flow consists almost entirely of held orders must also become prepared to provide disclosures that focus on trading activity characteristics of not held orders.

In the Commission's view, the potential benefits of the Rule 606(b)(3) disclosures for customers of such broker-dealers do not justify the costs to such broker-dealers of developing the necessary systems and mechanisms for providing the disclosures. There would be no expected benefits of Rule 606(b)(3) in circumstances where a broker-dealer does not currently handle any not held NMS stock order flow. Nevertheless, absent a de minimis exception, such a broker-

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118 See Capital Group Letter at 4.

dealer could feel compelled to incur the costs and burdens associated with being able to provide the Rule 606(b)(3) disclosures in order to ensure compliance with the rule should it receive not held orders in the future. The Commission believes that it is appropriate to relieve any such broker-dealers of these potential costs and unnecessary burdens.

Likewise, there would be only limited benefits of Rule 606(b)(3) in circumstances where broker-dealers handle a minimal amount of not held orders, and the Commission does not believe that such benefits would justify the costs to broker-dealers in these circumstances. While some commenters opposed a de minimis exemption on grounds that institutional customers should be able to compare orders across all broker-dealers and that broker-dealers capable of handling institutional customer orders should be able to provide the Rule 606(b)(3) information,[119] the Commission believes that these comments rest on an unlikely premise that it is broker-dealers that handle primarily institutional customer orders that would be excepted under Rule 606(b)(4). To the contrary, consistent with other commenters' views,[120] the Commission expects the de minimis exceptions to be relevant mainly in the context of broker-dealers that handle almost entirely held orders from customers but may occasionally handle not held orders from customers. Indeed, commenters noted that a small percentage of retail customers may submit not held orders, whether for purposes of working an order in illiquid securities or for other purposes. In these circumstances, the Commission believes that broker-dealers that focus on servicing such customers should not be required to incur the costs or burdens associated with building the systems and other capabilities necessary to provide the Rule

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119 See MFA Letter at 4-5; Capital Group Letter at 4.

120 See, e.g., Ameritrade Letter at 2; Citadel Letter at 3.

606(b)(3) disclosures when they are likely to handle not held orders only occasionally and separate from their core business of handling held orders.[121]

Accordingly, the firm-level de minimis exception to Rule 606(b)(3), as expressed in Rule 606(b)(4), focuses on the broker-dealer's overall order flow across all of its customers. The Commission believes that the scope of this exception will appropriately cover most broker-dealers that handle almost entirely held order flow. A broker-dealer that handles not held NMS stock order flow that is less than 5% of the total shares of NMS stock orders in a six calendar month period that it receives from its customers most likely does not make, as a matter of course, the routing decisions for which Rule 606(b)(3) is designed to provide enhanced transparency. 95% or more of such a broker-dealer's NMS stock order flow would be held orders. The Commission does not believe that it is appropriate to require such a broker-dealer to expend the effort and incur the expense necessary to be able to provide disclosures that are primarily aimed at order handling that is rarely, if ever, employed by the broker-dealer.

The Commission is adopting a firm-level de minimis exception that is based on the "percentage of shares of not held orders in NMS stocks the broker or dealer received from its customers" (emphasis added) rather than the percentage of not held orders in NMS stocks or other measures suggested by commenters.[122] The purpose of the firm-level de minimis exception is to except from the Rule 606(b)(3) disclosure requirements those broker-dealers that receive zero or minimal not held NMS stock order flow from their customers and whose core business does not involve handling or routing such order flow. The Commission believes that the percentage of shares of not held orders is an appropriate measure for the calculation of the firm-

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121 See Wells Fargo Letter at 5.

122 See, e.g., Schwab Letter II at 2.

level de minimis exception because it more accurately reflects the nature of a broker-dealer's business activities than other suggested approaches.

The other methods that commenters suggested for calculating a firm-level de minimis threshold — e.g., based on the percentage of not held orders (not shares) in NMS stocks — are in the Commission's view less accurate indicia of the broker-dealers to whom this aspect of Rule 606 is intended to apply and therefore would result in a less tailored exception. For example, the use of a "per order" threshold for the firm-wide de minimis exception would result in the equal treatment for purposes of a firm's de minimis calculation of, on the one hand, a single order for 10 shares of Corporation X, and on the other hand, a single order for 100,000 shares of Corporation X. The Commission believes that in this example, the two orders should not be afforded equal treatment and that the order for 100,000 shares is more indicative of the broker-dealer's business and thus should be given greater weight than the order for 10 shares.

Indeed, in the aforementioned example, the broker-dealer would likely need to apply more discretion when executing the order for 100,000 shares (to minimize potential information leakage and price impact) than for an order for 10 shares. As discussed above, the new Rule 606(b)(3) disclosures are intended to provide customers with detailed information concerning how broker-dealers exercise discretion, particularly for larger orders (including those broken up into several smaller child orders). Thus, if the firm-level de minimis threshold were calculated in a manner that did not account for shares received, there would be greater risk that a broker-dealer exercising discretion in handling larger orders, potentially as a meaningful portion of its business, would not be subject to the new Rule 606(b)(3) disclosure requirement.

As noted below, Commission supplemental staff analysis found that among 342 broker-dealers that receive not held orders from customers, about 8% (28 broker-dealers) would receive

a de minimis exception from Rule 606(b)(3) requirements pursuant to Rule 606(b)(4).[123] 23 of the 28 broker-dealers that would be eligible for the de minimis exception receive not held orders less than 2.5% of the total shares of their orders in the sample and five of the 28 broker-dealers receive not held orders greater or equal to 2.5% and less than 5% of the total shares of their orders in the sample.[124] Thus, the 5% threshold in Rule 606(b)(4) creates a narrow exception from Rule 606(b)(3) among broker-dealers that receive not held orders from customers and would allow for a reasonably small increase in not held order flow as a percentage of total order flow before one of these broker-dealers would be subject to the requirements of Rule 606(b)(3). Those broker-dealers covered by the exception likely handle not held NMS stock order flow only occasionally and separate from their core business, and therefore, in the Commission's view, should not be subject to the requirements of Rule 606(b)(3). In addition, some commenters that supported a firm-level de minimis exception specifically suggested that the threshold be set at the 5% level.[125] Accordingly, the Commission believes that the 5% threshold for the firm-level de minimis exception is reasonable given the goals of the rule.

A broker-dealer is covered by the firm-level de minimis exception as long as its customer not held NMS stock order flow continues to be less than the 5% firm-level threshold. A broker-dealer is no longer excepted from the purview of Rule 606(b)(3) once and as long as it meets or surpasses the firm-level threshold of the de minimis exception. Specifically, when a broker-dealer has equaled or exceeded the firm-level threshold, it must comply with Rule 606(b)(3) for at least six calendar months ("Compliance Period") regardless of the volume of not held NMS

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123 See infra Section 0.C.0.0.0.

124 See id.

125 See supra note 109.

stock orders the broker-dealer receives from its customers during the Compliance Period.[126] Therefore, during the Compliance Period, the broker-dealer must provide the Rule 606(b)(3) report to a customer for any of the customer's not held NMS stock orders submitted to the broker-dealer during the Compliance Period (subject to the customer-level de minimis exception set forth in Rule 606(b)(5)). The Compliance Period begins the first calendar day of the next calendar month immediately following the end of the six calendar month period for which the broker-dealer equaled or exceeded the firm-level threshold, unless it is the first time the broker-dealer has equaled or exceeded the threshold.[127] The first time a broker-dealer equals or exceeds the firm-level threshold, there is a grace period of three calendar months before the Compliance Period begins and the broker-dealer must comply with Rule 606(b)(3) requirements.[128] The customer is not entitled to receive Rule 606(b)(3) reports for orders handled during the grace period, as the grace period is not part of the Compliance Period. After the three calendar month grace period, beginning the first calendar day of the fourth calendar month after the end of the six calendar month period for which the broker-dealer equaled or exceeded the firm-level threshold, the broker-dealer must provide the Rule 606(b)(3) report prospectively for not held NMS stock orders submitted by customers from that date through the next six calendar months.

The Commission believes that the limited three-month grace period is appropriate because it will allow a firm time to come into compliance with the Rule 606(b)(3) requirements when its not held NMS stock order flow crosses the Rule 606(b)(4) firm-level de minimis threshold for the first time. The grace period affords a broker-dealer time to develop the systems and processes and organize the resources necessary to generate the Rule 606(b)(3) reports. At

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126 See Rule 606(b)(4).

127 See id.

128 See id.

the same time, should such a broker-dealer subsequently fall below the de minimis threshold, the Commission believes that no such grace period for Rule 606(b)(3) is necessary if and when that broker-dealer's not held NMS stock order flow again meets or crosses the firm-level de minimis threshold such that the broker-dealer is again subject to the Rule 606(b)(3) requirements. The broker-dealer should already have developed the necessary systems and processes for providing the Rule 606(b)(3) report in connection with its subjection to Rule 606(b)(3).[129]

Rule 606(b)(4) requires compliance with Rule 606(b)(3) for "at least" six calendar months for a broker-dealer that equals or exceeds the firm-level de minimis threshold. The Commission believes that it is appropriate to require a minimum Compliance Period of six calendar months in order to coincide with the six-month timeframe of Rule 606(b)(3). Customers of a broker-dealer that is or becomes subject to Rule 606(b)(3) therefore will be able to request a Rule 606(b)(3) report that contains at least one full time period of disclosures contemplated by Rule 606(b)(3).[130] There is no maximum period of time that a broker-dealer may be subject to Rule 606(b)(3) – a broker-dealer that consistently receives not held NMS stock orders from its customers at a rate that equals or exceeds the 5% threshold will be required to

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129 A broker-dealer whose not held NMS stock order flow from its customers equals or exceeds the five percent threshold must be able to provide the Rule 606(b)(3) reports to its customers beginning on the compliance date for these rule amendments. As such, broker-dealers will need to determine whether their customer not held NMS stock order flow equaled or exceeded the 5% threshold for the six calendar month period that ends in the calendar month that includes the effective date of these rule amendments. Since the compliance date for these rule amendments is 180 days after publication in the Federal Register, and since the effective date is 60 days after Federal Register publication, broker-dealers that equaled or exceeded the 5% threshold during the six calendar month period ending in the calendar month that includes the effective date will have nearly four months between the effective date and compliance date to prepare to provide the Rule 606(b)(3) reports.

130 As noted above, a broker-dealer is not required to provide the Rule 606(b)(3) report for orders received when the broker-dealer was not subject to Rule 606(b)(3). So, for example, a broker-dealer that is subject to Rule 606(b)(3) as of June 1 would be required to provide the Rule 606(b)(3) information for not held NMS stock orders received from a customer on June 1 through at least November 30 of that calendar year (subject to the customer-level de minimis exception and a three-month grace period if first time the firm is required to provide a report pursuant to Rule 606(b)(3)). A customer could request a Rule 606(b)(3) report prior to the end of that period, but the report would only be required to include disclosures as of June 1 (if there is no three-month grace period).

comply with Rule 606(b)(3) month after month. Rule 606(b)(4) is designed to require broker-dealer compliance with Rule 606(b)(3) for as long as the broker-dealer's not held NMS stock order flow from its customers equals or exceeds the 5% threshold, subject to the minimum Compliance Period of six calendar months.

Rule 606(b)(4) also is designed to enable a broker-dealer that is subject to Rule 606(b)(3) for six calendar months (or longer) subsequently to avail itself of the firm-level de minimis exception if its not held NMS stock order flow no longer equals or exceeds the 5% threshold. Specifically, under Rule 606(b)(4), if, at any time after the end of the Compliance Period, the broker-dealer's not held NMS stock order flow falls below the 5% threshold for the prior six calendar months, the broker-dealer is not required to comply with Rule 606(b)(3), except with respect to orders received during the Compliance Period.[131] Thus, after the broker-dealer's initial Compliance Period, Rule 606(b)(4) provides for a rolling month-to-month assessment of whether the broker-dealer must continue to comply with Rule 606(b)(3) or may avail itself of the Rule 606(b)(4) de minimis exception.

For example, suppose a broker-dealer has equaled or exceeded the firm-level threshold and therefore must comply with Rule 606(b)(3) for a six calendar month period that begins on January 1 and ends on June 30 (assuming this Compliance Period started after a three-month grace period, if this was the first time the broker-dealer has had to comply with Rule 606(b)(3)). If, in the beginning of July, the broker-dealer determines that its not held NMS stock order flow equaled or exceeded the threshold for January 1 through June 30, the broker-dealer must continue to comply with Rule 606(b)(3) for July. If, on the other hand, the broker-dealer determines that its not held NMS stock order flow was below the 5% threshold for January 1

[131] See Rule 606(b)(4). An example is set forth in the paragraph below.

through June, the broker-dealer would not be required to comply with Rule 606(b)(3) for July 1 through July 31. In the beginning of August, the broker-dealer would determine if it is subject to Rule 606(b)(3) based on its order flow for the prior six calendar month period, which this time would be the period from February 1 through July 31. If the broker-dealer met the threshold for that six calendar month period, and had also met it for the period January 1 through June 30 such that it was required to comply with Rule 606(b)(3) for July, the broker-dealer would be required to continue complying with Rule 606(b)(3) through August. If the broker-dealer met the threshold for the February 1 through July 31 period but had not met it for the January 1 through June 30 period and was not required to comply with Rule 606(b)(3) for July, the broker-dealer would start a new Compliance Period that would run from August 1 through January 31 of the following calendar year. In this scenario, the broker-dealer would be required to provide Rule 606(b)(3) disclosures for not held NMS stock orders received from a customer during the prior six calendar months, except for any such orders that the broker-dealer received during July when the broker-dealer was not required to provide reports pursuant to Rule 606(b)(3).

Table A below contains an example of a broker-dealer firm that meets or exceeds the 5% de minimis threshold for the first time and enters a six-month Compliance Period after a three-month grace period. Table A below also reflects that, after the initial six-month Compliance Period, the broker-dealer's required compliance with Rule 606(b)(3) continues on a rolling month-to-month basis. Table B below contains an example where there is no grace period and a previously compliant broker-dealer firm begins a new Compliance Period after an intervening period of not meeting the 5% threshold.

Table A: Firm equals or exceeds 5% threshold for the first time		
Event	**Period examined for qualifying threshold**	**Obligation**
Firm determines in Jan. 2020 that it equaled/exceeded threshold for first time; grace period begins	July 1 - Dec. 31, 2019	Prepare to collect and report required data for Compliance Period beginning Apr. 1, 2020
On Apr. 1, 2020, grace period ends and six-month Compliance Period begins	Reporting is mandatory during Compliance Period regardless of whether threshold is equaled or exceeded in prior six calendar months	Begin collection of required data for orders received during Compliance Period
May 2020		Provide reports for Apr. 1 to Apr. 30, 2020
June 2020		Provide reports for Apr. 1 to May 31, 2020 (continue adding prior month's data to report each successive month of the Compliance Period)
Initial Compliance Period ends on Sept. 30, 2020		Provide reports for full Compliance Period, Apr. 1 to Sept. 30, 2020 (Sept. data not required to be provided before 7th business day of Oct.)
On Oct. 1, firm determines that it equaled/exceed threshold; Compliance Period extends through Oct. 31, 2020	Apr. 1 to Sept. 30, 2020	Provide reports for May 1 to Oct. 31, 2020
On Nov. 1, firm determines that it equaled/exceed threshold; Compliance Period extends through Nov. 30, 2020	May 1 to Oct. 31, 2020	Provide reports for June 1 to Nov. 30, 2020
Continue assessing, on a rolling basis, whether equal/exceed threshold for prior six month period	Prior six calendar months, on a rolling basis	Provide reports for prior six month period as long as threshold continues to be met

Table B: Previously compliant firm equals or exceeds 5% threshold after intervening period of not meeting threshold		
Event	**Period examined for qualifying threshold**	**Obligation**
Firm determines in Jan. 2020 that it equaled/exceeded 5% threshold (not for the first time); six-month Compliance Period begins Jan. 1, 2020	July 1 to Dec. 31, 2019	Begin collection of required data for orders received during Compliance Period
Six-month Compliance Period ends on June 30, 2020	Reporting is mandatory during Compliance Period regardless of whether threshold is equaled or exceeded in prior six calendar months	Provide reports for full Compliance Period, Jan. 1 to June 30, 2020 (June data not required to be provided before 7th business day of July)
Firm determines in July 2020 that it did not equal/exceed threshold; Compliance Period not extended	Jan. 1 to June 30, 2020	Firm not required to collect or report data for July 2020 but must continue to provide reports for prior Compliance Period, Jan. 1 to June 30, 2020
Firm determines in Aug. 2020 that it equaled/exceeded threshold; new Compliance Period begins	Feb. 1 to July 31, 2020	Begin collection of required data for orders received during new Compliance Period, Aug. - Jan. 31, 2021; provide reports for portion of prior six months that is covered by a Compliance Period, i.e., Feb. 1 to June 30, 2020 (July 2020 not within Compliance Period)
Oct. 2020	Reporting is mandatory during Compliance Period regardless of whether threshold is equaled or exceeded in prior six calendar months	Provide reports for Apr. 1 to June 30, 2020; Aug. 1 to Sept. 30, 2020
Six-month Compliance Period ends on Jan. 31, 2021		Provide reports for Aug. 1, 2020 to Jan. 31, 2021 (Jan. 2021 data not required to be provided before 7th business day of Feb. 2021)

The other de minimis exception to Rule 606(b)(3) focuses on each customer's order flow.[132] Whereas the firm-level de minimis exception is designed to relieve mainly broker-dealers that do not regularly handle not held orders of the Rule 606(b)(3) obligations, the customer-level exception is designed to relieve broker-dealers from the obligation to provide the Rule 606(b)(3) disclosures to particular customers that do not trade NMS stocks in a manner that generally relies on a broker-dealer's use of discretion over order routing and handling.

The Commission expects that the benefits of the Rule 606(b)(3) disclosures will accrue mainly for customers that trade regularly with significant levels of not held NMS stock order flow. The new customer-specific order handling disclosures are intended to provide such customers with insight into how their brokers exercise order handling discretion over a period of time. In order to accurately reflect a broker's order handling behavior, the customer-specific disclosures must contain ample order data. The Commission believes that $1,000,000 of notional value traded on average each month for the prior six months is a level of order flow that would allow for meaningful order handling disclosures. A Rule 606(b)(3) report covering a customer's prior six months of trading activity would include at least $6 million worth of the customer's trades. The Commission believes that such a sample of trading activity would be large enough to not be misleadingly colored by one-off or infrequent routing choices by the broker-dealer or order handling requests by the customer. Therefore, such a sample size would provide the customer with an accurate and reliable depiction of how its broker-dealer generally handles its not held NMS stock order flow.

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132 See Rule 606(b)(5).

The Commission also believes that the customer-level de minimis threshold is set at a sufficiently low level such that the exception captures customers that do not trade regularly or in significant quantity and who would not therefore realize the benefits of the rule. Based on the Commission's experience and understanding of the frequency and quantities in which various market participants tend to trade, the Commission believes that this threshold is a relatively low one for more active traders, including customers that have an interest in evaluating their broker-dealers' order handling services, but high enough such that the exception will capture customers that trade infrequently or in small quantities and for whom the detailed Rule 606(b)(3) report would not be warranted or meaningful. Indeed, customers that trade on average each month for the prior six months less than $1,000,000 of notional value of not held orders through the broker-dealer are not likely to require the more complex order handling tools offered by the broker-dealer that would warrant or make meaningful a detailed review of the broker-dealer's order handling decisions. Even if a customer is sufficiently sophisticated to utilize not held orders and analyze the Rule 606(b)(3) information, unless the customer submits not held orders to a degree that generates a meaningful sample of order handling and routing data, the Rule 606(b)(3) report will not provide a reliable basis for assessing the broker-dealer's activity.

In addition, as discussed below,[133] part of the reason why the Rule 606(b)(3) information is provided in the aggregate for all orders sent to each venue, and not on an order-by-order basis, is to protect broker-dealers from potentially disclosing sensitive or proprietary information regarding their order handling techniques. If the rule allowed customers to request the disclosures for discrete not held orders or a de minimis level of not held order flow, there would be heightened risk that customers could gain insight into the broker-dealer's order handling

[133] See infra Section 0.A.0.

techniques by perhaps reverse engineering how the broker-dealer handled a particular order. A broker-dealer's internal process for determining how to handle and route individual orders – such as, for example, the specific routing destinations chosen and the timing for sending child orders – is typically highly sensitive and proprietary information that broker-dealers guard closely. By requiring the Rule 606(b)(3) disclosures only for non-de minimis levels of not held trading activity, the customer-level de minimis exception helps ensure that the aggregated information provided under Rule 606(b)(3) reflects a robust amount of trading activity from which a customer is unable to glean this sensitive or proprietary information.

While broker-dealers may, by rule, be excepted from Rule 606(b)(3) due to the firm-level de minimis exception, or excepted from providing the Rule 606(b)(3) disclosures to certain customers due to the customer-level de minimis exception, the Commission notes that some broker-dealers, for business reasons, may choose to provide the new customer-specific order handling disclosures to their customers regardless of the de minimis exceptions and that customers below the customer-level de minimis threshold could move their order flow to such firms.

v. Orders for the Account of a Broker-Dealer

As noted above, the Commission's proposed definition of institutional order explicitly excluded orders for the account of a broker-dealer, and such orders were not covered by proposed Rule 606(b)(3). Consistent with what was proposed, Rule 606(b)(3), as adopted, does not apply to orders from broker-dealers. Some commenters argued that orders for the account of a broker-dealer should be included in the order handling reports required under Rule 606 and, therefore, such orders should not be excluded from the proposed definition of institutional order

in Rule 600(b).[134] The Commission understands these comments to pertain to the proper scope of a broker-dealer's reporting obligations under Rule 606(b)(3), and as such they are discussed in detail in Section III.A.3, infra. As discussed in Section III.A.3, infra, the Commission continues to believe that the scope of a broker-dealer's obligation under Rule 606(b)(3) properly does not extend to orders placed by a broker-dealer.

vi. Rule 606(b)(1)

To incorporate new Rule 606(b)(3) into the existing regulatory structure, the Commission must make corresponding revisions to Rule 606(b)(1), which is the pre-existing customer-specific order routing disclosure rule. Prior to today, Rule 606(b)(1) did not differentiate between NMS stock orders from customers submitted on a held or not held basis. As a result, absent amendment to Rule 606(b)(1), not held orders in NMS stock that are covered by Rule 606(b)(3) also would be covered by Rule 606(b)(1). This is not the Commission's intent. As discussed above, the Commission is requiring Rule 606(b)(3) disclosures to be available for not held NMS stock orders, subject to two de minimis exceptions. For held NMS stock orders, or for instances when a de minimis exception would except a broker-dealer from providing Rule 606(b)(3) disclosures, the existing disclosure requirements of Rule 606(b)(1) would apply.

The Commission is amending Rule 606(b)(1) to require a broker-dealer, upon customer request, to provide the disclosures set forth in Rule 606(b)(1) for orders in NMS stock that are submitted on a held basis, and for orders in NMS stock that are submitted on a not held basis and for which the broker-dealer is not required to provide the customer a report under Rule 606(b)(3).[135] As a result, any NMS stock order from a customer triggers Rule 606(b) order

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134 See Markit Letter at 3 n.6, 18; Dash Letter at 1, 4-5; FIF Letter at 2, 8, 16-17; SIFMA Letter at 1, 3.

135 See Rule 606(b)(1). Rule 606(b)(1) also requires a broker-dealer to provide the disclosures for orders (whether held or not held) in NMS securities that are option contracts. As explained above (see supra note

handling disclosure requirements. This is consistent with the Commission's stated intent in the Proposal for all orders in NMS stock routed by broker-dealers for their customers to be encompassed by order routing disclosure rules regardless of order size.[136]

Because there is no dollar-value threshold in Rule 606(b) as adopted, there are two categories of NMS stock orders that would have been covered by Rule 606(b)(3) under the Proposal but instead are covered by Rule 606(b)(1) under the adopted approach. First, a customer's held NMS stock order that has a market value of at least $200,000 will be covered by the Rule 606(b)(1) disclosures (and, as discussed below, the Rule 606(a) public disclosures) whereas, under the Proposal, such an order would have been covered by the Rule 606(b)(3) disclosures.[137] As discussed above,[138] because broker-dealers must attempt to execute held NMS stock orders immediately and have no price or time routing discretion with such orders, the Commission does not believe that the Rule 606(b)(3) disclosures are appropriate for such orders, even if they are for $200,000 or more. Indeed, as explained supra and infra,[139] the Commission's concerns with respect to broker-dealer handling of held NMS stock orders relate mainly to financial inducements to attract held order flow from broker-dealers, and those concerns persist regardless of the size of the held order. Held NMS stock orders of any dollar value should therefore be covered by disclosures designed to provide more transparency into such financial

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83), the Commission is not altering Rule 606(b)'s application to orders for NMS securities that are option contracts, and so the adopted amendments to Rule 606(b)(1) continue the rule's prior application to option contract orders.

136 See Proposing Release, supra note 1, at 49445.

137 Conversely, a customer's not held order in NMS stock that has a market value less than $200,000 will be covered by the Rule 606(b)(3) disclosures whereas, under the Proposal, such an order would have been covered by the Rule 606(b)(1) disclosures (and the Rule 606(a) public disclosures). The Commission believes this is the proper result for the reasons set forth supra in Section 0.A.0.0.

138 See supra Section 0.A.0.0.0.

139 See id.; see also infra Section 0.0.0.0.

inducements and the potential conflicts of interest faced by broker-dealers which, as discussed infra, is what the enhancements to Rule 606(a) in particular are designed to achieve.[140]

Second, compared to the Proposal, a not held NMS stock order for at least $200,000 that is from a customer that does not meet the customer-level de minimis threshold or that the customer submits to a broker-dealer that qualifies for the firm-level de minimis exception will be covered by Rule 606(b)(1) whereas, under the Proposal, any not held NMS stock order for at least $200,000 would have been covered by Rule 606(b)(3). The Commission believes that it is the appropriate result for Rule 606(b)(3) not to apply to such an order and for Rule 606(b)(1) to apply instead. As discussed above,[141] the firm-level de minimis exception in Rule 606(b)(4) targets broker-dealers that mainly handle customer held orders but may occasionally handle a not held order from one of their customers. The Commission believes that such a broker-dealer should be entitled to the relief from Rule 606(b)(3) provided by the firm-level de minimis exception if it receives a large not held NMS stock order, including one that is for $200,000 or more, yet still does not receive aggregate not held NMS stock order flow that exceeds the firm-level de minimis threshold.

The Commission believes that, in most cases, a customer that trades in NMS stock order dollar values of $200,000 or more and is sufficiently sophisticated to utilize not held orders, will also be sufficiently sophisticated to submit such orders to broker-dealers that are not excepted from Rule 606(b)(3) by the firm-level de minimis exception, should the customer desire the Rule 606(b)(3) information (and meet or surpass the customer-level de minimis threshold). In addition, as discussed above, the customer-level de minimis exception targets customers whose

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140 See infra Section 0.0.0.0.

141 See infra Section 0.A.0.0.0.

trading activity is not substantial enough to provide a sample of data that would accurately and reliably reflect a broker-dealer's order handling behavior and make the Rule 606(b)(3) disclosures meaningful. Thus, should a customer that submits a not held NMS stock order for $200,000 or more not meet the customer-level de minimis threshold (a scenario that the Commission believes is unlikely to occur in most cases), the Commission believes that Rule 606(b)(1) is the appropriate recourse for the customer regardless of the dollar value of any of the customer's individual orders. If requested, the Rule 606(b)(1) disclosures provide the customer with information as to the venues to which its orders were routed, whether the orders were directed or non-directed, and the time of any transactions that resulted from the orders. The Commission believes that these disclosures provide information that is more meaningful in light of the overall extent to which the customer trades, and are sufficient to provide a basis for the customer to engage in further discussions with its broker-dealer regarding the broker-dealer's order handling practices.

vii. Definitions of "Directed Order" and "Non-Directed Order"

The Commission is adopting revised definitions of the terms "directed order"[142] and "non-directed order"[143] under Rule 600(b). These terms are used throughout Rule 606. They are referenced in Rule 606(a) and Rule 606(b)(1) and, as discussed infra,[144] are referenced in new Rule 606(b)(3). Therefore, these terms are being defined compatibly with Rule 606 as amended, which as adopted does not distinguish between NMS stock orders based on order dollar value.

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142 A directed order is a customer order that the customer specifically instructed the broker-dealer to route to a particular venue for execution. See 17 CFR 242.600(b)(19).

143 A non-directed order is any customer order other than a directed order. See 17 CFR 242.600(b)(48).

144 See Section 0.A.0.0.

Specifically, Rule 600(b) prior to these amendments defines the terms directed order and non-directed order in reference to a "customer order," and the term "customer order" includes a $200,000 dollar value threshold for NMS stock orders that the Commission is not incorporating into Rule 606 as amended. Thus, the Commission is removing the reference to "customer order" from the definitions of "directed order" and "non-directed order" to eliminate the $200,000 dollar-value threshold for NMS stock orders incorporated into those terms. Accordingly, as amended, the term "directed order" means an order from a customer that the customer specifically instructed the broker-dealer to route to a particular venue for execution, and the term "non-directed order" means any order from a customer other than a directed order.[145] By eliminating the term "customer order" and instead referring to "an order from a customer," these amended definitions do not incorporate the dollar value limitations in the definition of the term "customer order."

Otherwise, however, the amended definitions of "directed order" and "non-directed order" are consistent with the pre-existing definitions. While the amended definitions eliminate the previously existing order dollar value limitation in the cross-referenced term "customer order," they maintain the pre-existing definitions' exclusion of orders from a broker-dealer. In this regard, the Commission notes that the amended definitions of "directed order" and "non-directed order" continue to incorporate the term "customer," which is defined in Rule 600(b) as any person that is not a broker-dealer.[146] Thus, the defined terms "directed order" and "non-directed order," as amended, apply only to orders that are from a person that is not a broker-dealer.

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145 See Rules 600(b)(20) and 600(b)(49).

146 See 17 CFR 242.600(b)(16).

2. Definition of Actionable Indication of Interest

a. Proposal

To further facilitate the updated order handling disclosure regime, the Commission proposed to amend Rule 600 to include a definition of "actionable indication of interest."[147] Specifically, the Commission proposed that, under proposed Rule 600(b)(1) of Regulation NMS, an actionable IOI be defined as "any indication of interest that explicitly or implicitly conveys all of the following information with respect to any order available at the venue sending the indication of interest: (1) symbol; (2) side (buy or sell); (3) a price that is equal to or better than the national best bid for buy orders and the national best offer for sell orders; and (4) a size that is at least equal to one round lot."[148]

b. Final Rule and Response to Comments

The Commission is adopting as proposed the definition of actionable indication of interest under Rule 600(b)(1) of Regulation NMS.[149] Accordingly, under final Rule 600(b)(1), actionable IOI means any indication of interest that explicitly or implicitly conveys all of the following information with respect to any order available at the venue sending the indication of interest: (1) symbol; (2) side (buy or sell); (3) a price that is equal to or better than the national

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147 See proposed Rule 600(b)(1). As the Commission indicated in 2009, an actionable IOI is a privately transmitted message by certain trading centers, such as an ATS or an internalizing broker-dealer, to selected market participants to attract immediately executable order flow to such trading centers, and functions in some respects similarly to a displayed order or a quotation. See Securities Exchange Act Release No. 60997 (November 13, 2009), 74 FR 61208, 61210 (November 23, 2009) ("Regulation of Non-Public Trading Interest Proposing Release").

148 See proposed Rule 600(b)(1). See also Proposing Release, supra note 1, at 49445-49447 for additional detail on the Commission's proposal. As noted in the Proposing Release, this definition is based on and substantively similar to the Commission's description of actionable IOIs in the Regulation of Non-Public Trading Proposing Release in 2009. See Regulation of Non-Public Trading Interest Proposing Release, supra note 147.

149 See Rule 600(b)(1).

best bid for buy orders and the national best offer for sell orders; and (4) a size that is at least equal to one round lot.

By defining actionable IOIs in this manner, the Rule 606(b)(3) order handling reporting requirements mandate that a broker-dealer disclose its activity communicating to external liquidity providers for them to send an order to the broker-dealer in response to a not held NMS stock order of a customer of the broker-dealer. The Commission continues to believe that including these disclosures relating to actionable IOI activity in the Rule 606(b)(3) order handling reports would better enable customers to understand and evaluate how broker-dealers handle their orders, in particular with respect to the potential for information leakage stemming from broker-dealers' use of actionable IOIs. The Commission also continues to believe that the definition of actionable IOI is appropriately designed to capture trading interest that is the functional equivalent to an order or quotation.

Commenters generally supported the creation of a definition of actionable IOI in Rule 600(b), but some commenters expressed concerns about and suggested revisions to the Commission's proposed definition.[150] One of the main concerns was that it was not sufficiently clear from the Proposal what it means for an IOI to be "actionable."[151] In this regard, some commenters suggested that the proposed definition could be read to capture conditional orders or

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150 See, e.g., Fidelity Letter at 3-4; FIF Letter at 7; Bloomberg Letter at 13-15; SIFMA Letter at 6.

151 See, e.g., FSR Letter at 2, 6-7; Bloomberg Letter at 13-14; FIF Letter at 7; HMA Letter at 10. One of these commenters stated that broker-dealer order routers respond to IOIs but do not send them, and that the inclusion of IOIs in the Proposal appeared out of context with order routing transparency. See Bloomberg Letter at 13. This is not consistent with the Commission's understanding, which, as noted in the Proposing Release, is that broker-dealers may send an actionable IOI to select external liquidity providers to communicate to send orders to the broker-dealer to trade with the order that is represented by the actionable IOI at the broker-dealer. See Proposing Release, supra note 1, at 49453; see also Section 0.A.0.0, infra.

IOIs that require additional negotiation or "firming up" to be executable by the broker-dealer,[152] and several commenters asserted that such conditional trading interest is distinguishable from an actionable IOI and therefore should be excluded from the definition of actionable IOI and the disclosures required by Rule 606.[153]

As stated above and in the Proposing Release, for an IOI to be actionable it must convey (explicitly or implicitly) information sufficient to attract immediately executable orders to the venue sending the indication of interest.[154] In addition, Rule 3b-16 defines an order as any firm indication of a willingness to buy or sell a security, as either principal or agent, including any bid or offer quotation, market order, limit order, or other priced order.[155] When the Commission adopted Rule 3b-16 in connection with the adoption of Regulation ATS, the Commission stated:

> Whether or not an indication of interest is 'firm' will depend on what actually takes place between the buyer and seller…. At a minimum, an indication of interest will be considered firm if it can be executed without further agreement of the person entering the indication. Even if the person must give its subsequent assent to an execution, however, the indication will still be considered firm if this subsequent agreement is always, or almost always, granted so that the agreement is largely a formality. For instance, indications of interest where there is a clear prevailing presumption that a trade will take place at the indicated price, based on understandings or past dealings, will be viewed as orders.[156]

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152 See FSR Letter at 2, 6-7; Fidelity Letter at 4; Letter from Timothy J. Mahoney, Chief Executive Officer, BIDS Trading L.P., dated October 7, 2016 ("BIDS Letter").

153 See Markit Letter at 4, 12-13; Bloomberg Letter at 14; BIDS Letter; SIFMA Letter at 6; EMSAC Rule 606 Recommendations, supra note 16, at 3. One commenter stated that, absent clarification, the Proposing Release's definition of actionable IOIs would be inconsistent with the Commission's published understanding of conditional orders in the ATS-N Proposing Release. See BIDS Letter at 4. The clarification, set forth below, of the difference between actionable IOIs versus IOIs or conditional orders that require additional agreement of the broker-dealer responsible for the IOI or conditional order before an execution can take place is consistent with what is stated in the ATS-N Adopting Release. See ATS-N Adopting Release, supra note 2, at 38847-38848.

154 See Proposing Release, supra note 1, at 49446.

155 See 17 CFR 240.3b-16.

156 See Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844, 70850 (December 22, 1998).

The Commission believes that this language is instructive here in light of the Commission's intention for the definition of actionable IOIs to apply to IOIs that are the functional equivalent of orders or quotations, i.e., firm representations of trading interest. Specifically, the Commission intends that the actionable IOI definition would include, at a minimum, an IOI that represents an order that can be executed against by the IOI recipient without further agreement of the broker-dealer that communicated the IOI. Moreover, indications of interest where the agreement of the parties to the terms of a trade is presumed from the facts or circumstances, such as past dealings or a course of conduct between the parties, may also be considered actionable IOIs. Indeed, in the context of dark pools, the Commission has previously noted that IOIs may communicate information explicitly or implicitly, such as through a course of conduct, based on which the recipient of the IOI can reasonably conclude that sending a contra-side marketable order responding to the IOI will result in an execution if the trading interest has not already been executed against or cancelled.[157] The Commission believes that, generally, it would consider an IOI from a broker-dealer to be actionable if it fits this description, i.e., if the IOI recipient can reasonably conclude that sending a contra-side marketable order to the broker-dealer will result in an execution against trading interest represented by the IOI that has not already been executed against or cancelled.

So-called "conditional" orders referenced by several commenters would not, therefore, constitute actionable IOIs if they require additional agreement by the broker-dealer responsible for the conditional order before an execution can occur, unless facts or circumstances suggest that the broker-dealer's agreement can be presumed. The Commission believes that IOIs that do not enable the IOI recipient to send a marketable order to the IOI sender that is executable

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[157] See Regulation of Non-Public Trading Interest Proposing Release, supra note 147, at 61211.

against the interest represented by the IOI without further agreement by the IOI sender may not function equivalently to orders or quotations and therefore do not represent the sort of order handling activity that the Rule 606(b)(3) order handling reports are meant to capture.

Moreover, as noted in the Proposal, actionable IOIs have the capacity to communicate information about the existence of a large parent order, and as such their usage, like other components of broker-dealers' order handling and routing practices, creates the potential for information leakage.[158] The Commission believes that disclosing in the Rule 606(b)(3) order handling reports information regarding a broker-dealer's use of actionable IOIs could help enable its customers to assess the degree to which the trading interest they route to the broker-dealer is subject to potential information leakage. By contrast, the Commission does not believe that this same utility would exist if non-actionable IOIs (those that are not executable without further agreement) were to be included in the customer-specific order handling reports, as the Commission does not understand such non-actionable IOIs to present the same risk of information leakage as actionable IOIs.

In addition, the Commission continues to believe that the four elements contained in the definition of actionable IOI (symbol, side, price, and size) are all necessary pieces of information for an external liquidity provider to respond with an order that is immediately executable against trading interest of a customer of the broker-dealer responsible for the IOI. The Commission emphasizes that these pieces of information may be implicitly conveyed, such as via a course of dealing between the IOI sender and the recipient. For example, given that Rule 611 of Regulation NMS generally prevents trading centers from executing orders at prices inferior to the NBBO, if a broker-dealer sends an IOI communicating an interest to buy a specific NMS

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158 See Proposing Release, supra note 1, at 49446.

stock, the IOI recipient reasonably can assume that the associated price is the NBBO or better.[159] Moreover, the IOI recipient may have responded previously with orders to the IOI sender and repeatedly received executions at the NBBO or better with a size of at least one round lot.[160] In this example, the IOI communicated by the broker-dealer would be actionable, with explicit conveyance of the symbol and side elements and implicit conveyance of the price and size elements. Indeed, the Commission understands that IOIs are frequently conveyed with explicit side and symbol terms and implicit price and size terms, and can be executed against by the IOI recipient without further agreement of the IOI sender.

One commenter stated that, for the purpose of routing brokers determining whether to send an order to a non-displayed venue, an IOI should have, at a minimum, a symbol.[161] Another commenter stated that, at a minimum, symbol and side (buy or sell) must be included with an IOI in order for it to be an actionable IOI, and that size or price do not need to be explicitly included.[162] While these comments may suggest that an IOI could still be actionable with less than the four noted elements in the definition, the Commission believes that, without the inclusion of all four elements (symbol, side, price, and size) explicitly or implicitly with the IOI, the IOI recipient could require additional information before executing against the IOI and the IOI therefore may not be actionable. To the extent these comments suggest that one or more of the four noted elements of an actionable IOI may be implicitly conveyed, as noted above, the Commission agrees. One commenter stated that the Commission has captured all the necessary elements for the actionable IOI definition, but that the definitions of two of the elements —

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159 See Regulation of Non-Public Trading Interest Proposing Release, supra note 147, at 61211.

160 See id.

161 See Markit Letter at 15.

162 See Letter from Elizabeth K. King, General Counsel and Corporate Secretary, NYSE Group, dated October 31, 2016 ("NYSE Letter") at 2.

quantity and price — should be expanded to include relative measures in addition to absolute measures.[163] The Commission notes in response that if each of the four elements is communicated — explicitly or implicitly — such that the IOI recipient can respond to the IOI with an order that is executable against trading interest represented by the IOI without further agreement by the IOI sender (taking into account the relevant facts and circumstances, including any course of dealing between the parties), that communication would constitute an actionable IOI under the definition in Rule 600(b)(1).

The Commission does not believe that it is necessary for purposes of the definition of actionable IOI to draw a distinction between IOIs that are communicated manually (such as via the telephone, for example) versus IOIs that are communicated electronically. Some commenters drew such a distinction, and suggested that only IOIs that are communicated and accessible electronically should constitute actionable IOIs under Rule 600(b)(1).[164] The Commission believes that whether an IOI is actionable should not turn on the level of automation involved in the communication of the IOI. Once an IOI is communicated by a broker-dealer to the IOI recipient, regardless of whether the communication is manual (such as via telephone) or electronic, if that IOI recipient can respond to the IOI with an order that is executable against the trading interest represented by the IOI without further agreement by the broker-dealer responsible for the IOI, then the IOI should be considered an actionable IOI under Rule 600(b)(1). An actionable IOI has the potential to leak information as to the existence of an order regardless of whether the actionable IOI is transmitted electronically or manually. Thus, order handling statistics regarding both electronic and manual actionable IOIs could be valuable to

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163 See Capital Group Letter at 3-4.

164 See Bloomberg Letter at 13-15; FIF Letter at 7; FIF Addendum at 4 n.7; Fidelity Letter at 4; SIFMA Letter at 6.

customers in evaluating the order routing practices of their broker-dealers and the degree to which those practices may leak information regarding their not held NMS stock orders.

One commenter urged the Commission to follow the commenter's characterization of how IOIs were described in the Regulation of Non-Public Trading Interest Proposing Release by targeting IOIs sent by venues such as ATSs, and to consider whether other market participants that send IOIs, such as exchanges, should be included within the scope of the rule.[165] The purpose of the Regulation of Non-Public Trading Interest Proposing Release, however, was different from the Commission's purposes here in adopting the definition of actionable IOI for the new customer-specific order handling reports. There, due to the Commission's concern about potentially deleterious effects of dark pools' transmission to selected market participants, and not the public broadly via the consolidated quotation data, of valuable pricing information in the form of actionable IOIs that function similarly to quotations, the Commission proposed to amend the Exchange Act quoting requirements in Rule 602 of Regulation NMS and Rule 301(b)(3) of Regulation ATS to apply expressly to actionable IOIs.[166] Here, by contrast, the Commission's purpose is to require broker-dealers to provide order handling and routing information that is sufficient for their customers to understand the methods their broker-dealers use to carry out their best execution obligations and assess the potential impact of information leakage and conflicts of interest, not to provide public access to comprehensive pricing information or encourage the public display of quotations. The Commission believes that the definition of actionable IOI being adopted today is appropriately tailored to serve the purpose of

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165 See Bloomberg Letter at 13-15; see also Regulation of Non-Public Trading Interest Proposing Release, supra note 147.

166 See Regulation of Non-Public Trading Proposing Release, supra note 147, at 61211-12.

this rulemaking, and that the concerns it expressed in the Regulation of Non-Public Trading Proposing Release are outside the scope of this rulemaking.

For similar reasons, the Commission is not excluding from the definition of actionable IOI in Rule 600(b)(1) an IOI for a quantity of NMS stock having a market value of at least $200,000 that is communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000, as suggested by one commenter.[167] The Commission likewise is not requiring broker-dealers to disclose in the publicly available reports the percentage of orders that were exposed through so-called "size-discovery IOIs," as suggested by another commenter.[168] These commenters noted that the Regulation of Non-Public Trading Proposing Release proposed to exclude such "size-discovery IOIs" from the rule amendments proposed therein,[169] but the Commission again notes that the purpose of the Commission's actions here is different from what it was in the Regulation of Non-Public Trading Proposing Release. There, the Commission recognized that the benefits of certain size-discovery mechanisms could be undermined if their narrowly tailored IOIs for large size were required to be included in the public quotation data.[170] Here, by contrast, the Commission is not requiring that actionable IOIs be included in public quotation data, and thus the Commission does not believe that the same concern is implicated.

Finally, in response to commenters who requested clarification as to whether rules, regulations, and guidance applicable to quotes or orders would be applicable to actionable IOIs

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167 See Bloomberg Letter at 14-15.

168 See NYSE Letter at 1-2.

169 See Bloomberg Letter at 14; NYSE Letter at 2.

170 See id. at 61213.

under the final rule,[171] the Commission is defining actionable IOIs at this time for purposes of the Rule 606 amendments also being adopted today. The Commission is not expanding the scope of existing rules, regulations, or guidance related to orders or quotations, other than Rule 606 and guidance related thereto, with regard to actionable IOIs.

3. Scope of Broker-Dealer's Obligation Under Rule 606(b)(3)

a. Broker-Dealer Required to Provide Report on its Order Handling to Customer Placing Order with the Broker-Dealer

i. Proposal

The Commission proposed in Rule 606(b)(3) that every broker-dealer shall, on request of a customer that places, directly or indirectly, an institutional order with the broker-dealer, disclose to such customer a report on its handling of institutional orders for that customer.[172] The Commission noted in the Proposal that, pursuant to this rule language, a broker-dealer would be required to provide the order handling report to the customer placing the institutional order with the broker-dealer, even if the customer is acting on behalf of others and is not the ultimate beneficiary of any resulting transactions.[173] Thus, the broker-dealer would not be required to provide the order handling report to the underlying clients of that customer.

The Commission also noted that the proposed report would cover instances where an institutional order is handled either directly by the broker-dealer or indirectly through systems provided by the broker-dealer.[174] By way of example, the Commission stated that an institutional order would have been placed with a broker-dealer if a broker-dealer receives an institutional order directly from a customer and works to execute the order itself, as well as if a

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171 See Fidelity Letter at 4; SIFMA Letter at 6.

172 See proposed Rule 606(b)(3).

173 See Proposing Release, supra note 1, at 49448.

174 See id. at 49447.

broker-dealer receives an institutional order indirectly from a customer, where the customer self-directs its institutional order by entering it into a routing system or execution algorithm provided by the broker-dealer.[175]

Further, the Commission did not propose to change the existing definition of customer in Rule 600(b), which states that "customer" means any person that is not a broker-dealer.[176] In utilizing this defined term, proposed Rule 606(b)(3) therefore required a broker-dealer to provide the customer-specific institutional order handling report only to a non-broker-dealer.[177]

ii. Final Rule and Response to Comments

Notwithstanding that Rule 606(b)(3) is modified from what was proposed such that the adopted rule covers not held NMS stock orders of any dollar value (subject to the two de minimis exceptions), the person or entity to which the broker-dealer must provide the Rule 606(b)(3) report is the same as under the Proposal. Specifically, under Rule 606(b)(3), every broker-dealer must, on request of a customer that places, directly or indirectly, one or more orders in NMS stock that are submitted on a not held basis with the broker-dealer, disclose to such customer a report on its handling of such orders for that customer. In other words, the broker-dealer must provide the Rule 606(b)(3) report to the customer that places with the broker-dealer the orders covered by Rule 606(b)(3), even if the customer is acting on behalf of others and is not the ultimate beneficiary of any resulting transactions. In addition, broker-dealers remain excluded from the definition of "customer" in Rule 600(b), and that exclusion is maintained for purposes of Rule 606(b)(3), which cross-references the defined term "customer."

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175 See id.

176 See 17 CFR 242.600(b)(16).

177 See Proposing Release, supra note 1, at 49447-48 for additional detail on the Commission's proposal.

As a result, under Rule 606(b)(3) as adopted, a broker-dealer is required to provide the report only to non-broker-dealers.

For the same reasons as stated in the Proposal, the Commission continues to believe that a broker-dealer should be required to provide the customer-specific order handling report to the customer that places the order with the broker-dealer, even if that customer may be acting on behalf of others and is not the ultimate beneficiary of any resulting transactions, such as when an investment adviser, as the customer of a broker-dealer, places an order with the broker-dealer that represents the trading interest of clients of the investment adviser.[178] Multiple commenters supported this delineation of Rule 606(b)(3)'s scope.[179] In addition, the Rule 606(b)(3) report requirement covers instances where an order is handled either directly by the broker-dealer or indirectly through systems provided by the broker-dealer. The Commission continues to believe that requiring the reports to be provided to the customer that places the order with the broker-dealer – whether the customer is the account holder or an investment adviser or other fiduciary – is appropriate because it would require the broker-dealer to provide detailed information to the person that is responsible for making the routing and execution decisions for such order and for assuring the effectiveness of those functions. Despite one commenter's assertion that an investment adviser's underlying client also should be entitled to receive the Rule 606(b)(3) report from the adviser's broker-dealer,[180] the Commission does not believe it is appropriate to require a broker-dealer to create individualized order handling reports for and make its execution data available to an end user with whom the broker-dealer may have no direct relationship.

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178 As discussed infra in this section, a broker-dealer is required to report to the customer that places the order with the broker-dealer so long as the customer is not itself a broker-dealer.

179 See Markit Letter at 16, 18; Bloomberg Letter at 16; Capital Group Letter at 4; FIF Letter at 7-8, 16; EMSAC Rule 606 Recommendations, supra note 16, at 3.

180 See Better Markets Letter at 7-8.

One commenter stated that an account-level report should not be required because accounts often are assigned after the order is entered via an allocation process that is different from the system that handles routing, and thus it would be costly.[181] This commenter also stated it would require brokers, when using a third party to generate the reports, to transmit client account numbers, which are more sensitive and confidential than the name of the institutional manager.[182] This commenter also stated, however, that reporting information in the aggregate should prevent any secret routing strategies from being divulged.[183] In addition, another commenter stated it did not believe that customers will able to reverse engineer the way a smart order router works or discern any other proprietary information about the broker's technology or order handling techniques from the proposed disclosure information.[184]

Consistent with these comments, the Commission continues to believe that, because the Rule 606(b)(3) customer-specific order handling disclosures will aggregate information to be disclosed to a specific customer across all of the customer's not held NMS stock orders, the risk that such disclosures would reveal sensitive, proprietary information about broker-dealers' order handling techniques should be minimal. The customer-level de minimis exception from Rule 606(b)(3) also is relevant in this regard, as it should help ensure that there is a significant level of trading activity reflected in the aggregated information provided to the customer under Rule 606(b)(3), and not information regarding just one or a few orders from which the customer may be able to discern aspects of the broker-dealer's sensitive or proprietary order handling techniques. A broker-dealer's sensitivity lies with its methods for determining how, where, and

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181 See Markit Letter at 16, 19-20.

182 See id.

183 See id. at 19.

184 See Capital Group Letter at 5.

when to route a specific, individual order. By providing information for all of the customer's orders in the aggregate, the report conceals a broker-dealer's proprietary determinations with respect to any specific, individual order. Even if the report reflected that the broker-dealer sent a small number of orders to a particular venue, the report would not reveal why the broker-dealer chose that particular venue, when the broker-dealer routed the orders to that venue, what market signals informed the broker-dealer's choices as to venue and timing, or what type of routing strategy the broker-dealer utilized. As to one commenter's assertion that account-level disclosure would require broker-dealers that use third-parties to generate the Rule 606(b)(3) report to disclose sensitive client account numbers to such third-parties, the Commission is not adopting any requirement that the Rule 606(b)(3) disclosures be provided at the client account level, and thus nothing in Rule 606(b)(3) compels a broker-dealer to disclose client account numbers to third-parties.

The Commission further notes that, because it is not altering the broker-dealer exclusion from the definition of customer, and because Rule 606(b)(3) utilizes this defined term, the rule does not require a broker-dealer to report to another broker-dealer. This is consistent with what was proposed and with the order routing disclosure regime that has existed under Rules 606(a) and 606(b)(1).[185]

Some commenters argued that the broker-dealer exclusion should be eliminated because a broker-dealer should be required, under Rule 606(b)(3), to report to the customer that places the order with the broker-dealer even if that customer is itself a broker-dealer.[186] Two commenters stated that, absent a modification to the Proposal, the Rule 606 report received by

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185 The Commission did not propose to modify the definition of "customer" in Rule 600(b)(16), which defines "customer to mean any person that is not a broker or dealer." See Rule 600(b)(16).

186 See Markit Letter at 3 n.6, 18; Dash Letter at 1, 4-5; FIF Letter at 2, 8, 16-17; SIFMA Letter at 1, 3.

the end-customer of a broker-dealer that utilizes another broker-dealer's technology for execution would reflect only that the customer's orders were sent by its broker-dealer to the other executing broker-dealer, and lack the level of detail that is necessary for the customer to assess execution quality.[187] Another commenter suggested that the Rule 606 reports exclude only those orders received from other broker-dealers and foreign banks acting as broker-dealers and routing to U.S. execution venues that were directed by such broker-dealers and foreign banks acting as broker-dealers to a particular execution venue.[188]

On the other hand, one commenter asserted that, in a "white-labeling" or leveraged outsourced technology arrangement, where a broker that receives an order from an institutional customer outsources another broker's smart order routing or algorithmic trading technology, the broker that received the order should be evaluating the effectiveness of the outsourced technology and should fulfill the obligation of being able to provide clients' reports on request.[189] Another commenter asserted that the Proposal is unclear as to whether a broker-dealer that provides algorithmic trading services would be required to provide an order handling report to a broker-dealer that utilizes those algorithmic trading services in the course of executing orders on behalf of institutional customers.[190]

In response to these comments, as an initial matter, it is worth highlighting that Rule 606(b)(3) requires a broker-dealer, upon request of a customer that places not held NMS stocks order with the broker-dealer, to disclose to such customer a report with respect to its — i.e., the broker-dealer's — handling of such orders for that customer. As such, Rule 606(b)(3) is

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187 See Dash Letter at 5; FIF Letter at 8 n. 9, 16-17.

188 See Markit Letter at 3 n.6.

189 See Bloomberg Letter at 16.

190 See STA Letter at 4-5; STA Letter II at 1.

designed to require a broker-dealer to disclose the information required by Rule 606(b)(3) to the extent of its involvement in routing and executing its customers' orders. If the broker-dealer exercises discretion with regard to how an order is routed and ultimately executed, such as (but not limited to) by determining particular venue destinations for an order, choosing among different trading algorithms, adjusting or customizing algorithm parameters, or performing other similar tasks involving its own judgment as to how and where to route and execute orders, the broker-dealer is required to provide the information required by Rule 606(b)(3) with regard to the customer's order flow with the broker-dealer as well as the order routing and execution information set forth in subparagraphs (b)(3)(i) through (iv) of the rule. If, by contrast, the broker-dealer simply forwards its customers' orders on to another broker-dealer and that second broker-dealer exercises all discretion in determining where and how to route and execute the orders, then the first broker-dealer is not required to provide disclosures under Rule 606(b)(3) beyond those relevant to its activity in forwarding orders to the executing broker. In either case, the broker-dealer reports the required information under Rule 606(b)(3) with respect to <u>its</u> order handling for a customer.

This language from the rule informs the scope of a broker-dealer's obligation in the types of scenarios that commenters raised. As noted by some commenters, broker-dealers sometimes license or outsource technology offerings, such as trading algorithms, from third-parties, including other broker-dealers, to use for routing and executing orders. In these so-called "white-labeling" scenarios, the broker-dealer typically exercises discretion in determining what trading algorithm or other technology offering to utilize on behalf of its customer, as well as how to handle the customer's orders using that technology. For example, the broker-dealer may be able to adjust discretionary parameters that determine the aggressiveness of a particular

algorithm,[191] otherwise determine where or how an order is routed and executed using the algorithm or other technology, or determine when the algorithm is turned "on" or "off." In this type of scenario, it is the broker-dealer utilizing the trading algorithm or other technology offering — and not the third-party provider of such algorithm or other technology — that handles the customer's order and that is obligated to provide the information required by Rule 606(b)(3). The broker-dealer's obligation in this scenario extends to the routing and execution of child orders that, for example, the trading algorithm may have placed after being "turned on" by the broker-dealer.[192]

The Commission understands that broker-dealers typically have access or rights to the execution data for trades made using algorithms or other technology that they license or outsource. As such, the Commission believes that most broker-dealers should be well-positioned to provide the Rule 606(b)(3) information to their customers for orders (or child orders thereof) that they routed or executed using a trading algorithm or other type of technology offering. Ultimately, however, when relying on third-party technology in this manner, broker-dealers will need to ensure that they can provide the information required by Rule 606(b)(3), should it be requested by a customer. Further, consistent with the exclusion of broker-dealers from the definition of customer, broker-dealers are required to report the Rule 606(b)(3) information only to non-broker-dealers.

In another type of arrangement raised by commenters, one broker-dealer, sometimes referred to as an introducing broker-dealer, will route an order on behalf of its customer to another broker-dealer, sometimes referred to as an executing broker-dealer, and the executing

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191 See, e.g., Markit Letter at 20; FIF Letter at 6.

192 See infra Section 0.A.0.0.

broker-dealer will carry out the further routing and ultimate execution of the order, perhaps utilizing trading algorithms or other technology. In this type of scenario, the executing broker-dealer's customer is the introducing broker-dealer because it is the introducing broker-dealer that places the order with the executing broker-dealer. Since, as discussed above, a broker-dealer is required to report only to the customer that places the order with the broker-dealer, in the introducing-broker-dealer/executing-broker-dealer arrangement, the executing broker-dealer is not required to report the Rule 606(b)(3) information to the introducing broker-dealer's customer. Moreover, Rule 606(b)(3) does not require the executing broker-dealer to report to the introducing broker-dealer in light of the broker-dealer exclusion from the definition of customer.

As noted above, some commenters argued that a different result would be appropriate under the rule; specifically, they argued that broker-dealers should be required to provide the Rule 606(b)(3) reports for broker-dealer orders.[193] The Commission intends, however, for Rule 606(b)(3) to be focused on the relationship between a customer (that is not a broker-dealer) and its broker-dealer, and the information that the customer receives from its broker-dealer with respect to how the broker-dealer handles the customer's not held NMS stock orders. Rule 606(b)(3) is designed to provide a customer with access to baseline information that would enable the customer to assess the nature and quality of services provided by its broker-dealer with respect to such orders, as many customers may not have the sophistication or leverage necessary to receive adequate information in the absence of a rule. The Commission does not believe that broker-dealer to broker-dealer relationships carry the same level of risk of an imbalance of information or sophistication on one side of the relationship as compared to customer to broker-dealer relationships. Therefore, the Commission has determined not to

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193 See supra note 186.

depart from the current practice under Rule 606 by including broker-dealer orders in Rule 606(b)(3).

For similar reasons, the Commission believes it is appropriate for the Rule 606(b)(3) requirements not to extend to orders handled by exchange-affiliated routing brokers, which are also excluded from Rule 606(b)(3)'s coverage by virtue of the broker-dealer exclusion from the definition of customer. Three commenters suggested that requiring the Rule 606(b)(3) disclosures for orders handled by exchange-affiliated routing brokers would provide market participants with a more complete picture as to how their orders are handled.[194] But since only broker-dealers can be members of an exchange, by the time an order reaches an exchange-affiliated routing broker, it first has traveled from the end customer to a broker-dealer, from a broker-dealer to the exchange (or perhaps from an end customer through a broker-dealer's systems via a market access arrangement and onto an exchange), and then from the exchange to the exchange's affiliated routing broker. Like an executing broker-dealer, an exchange-affiliated routing broker has no direct relationship with the customer that sent the order in the first place. Thus, the Commission does not believe that it would be appropriate to require an exchange-affiliated routing broker to provide the Rule 606(b)(3) information to the customer from whom the order originated. As noted above, the Commission's goal is for Rule 606(b)(3) to provide non-broker-dealer customers with access to baseline information that would enable them to assess the discretion exercised by their broker-dealers and the nature and quality of services provided by their broker-dealers with respect to their not held NMS stock orders. The

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194 See SIFMA Letter at 4; Markit Letter at 24; FIF Letter at 2, 8; EMSAC Rule 606 Recommendations, supra note 16.

Commission believes that this goal will still be achieved without including orders routed by exchanged-affiliated routing brokers.

A broker-dealer is still required to provide the Rule 606(b)(3) report to its customer, upon request, with respect to its handling of orders for that customer (assuming the customer is not a broker-dealer) even if the broker-dealer's handling of the customer's orders amounts mainly to routing them to another broker-dealer (including perhaps one affiliated with an exchange) for further routing. In such a situation, the report is required to include the information regarding the customer's order flow with the introducing broker-dealer required by Rule 606(b)(3), as well as the information on order routing required by subparagraph (b)(3)(i) of the rule, as this information pertains to the introducing broker-dealer's order handling even if that order handling amounts mainly to routing to an executing broker-dealer. But, in this scenario, Rule 606(b)(3) would not require the broker-dealer to provide the information on order executions required by subparagraphs (b)(3)(ii) through (iv) in its report to its customer. Because Rule 606(b)(3) requires a broker-dealer to provide the required information only with respect to "its" order handling, an introducing broker-dealer's obligation under Rule 606(b)(3) does not extend to the order handling activities of another broker-dealer.

Nevertheless, the Commission believes that competitive forces in the market may enable a customer whose orders are routed by its broker-dealer to another broker-dealer to receive detailed order execution information, such as that required by Rule 606(b)(3)(ii) through (iv), for such orders. Customers could choose not to send not held NMS stock orders to broker-dealers that are unable to provide detailed order execution information, the prospect of which could cause such broker-dealers to request the information from their executing broker-dealers that, in turn, may risk losing broker-dealers as customers unless they provide the information. Even if

this type of information sharing does not occur, a customer will still be entitled to receive information from its broker-dealer under Rule 606(b)(3) that illustrates how the broker-dealer is handling the customer's orders. With that information, the customer should be in a better position to determine whether its broker-dealer is adequately serving its investing and trading needs, as well as whether it would be better served by utilizing the services of a broker-dealer that is able to provide the full suite of detailed order handling information set forth in Rule 606(b)(3).

b. Smaller Orders Derived from the Order Submitted to the Broker-Dealer (i.e., Child Orders)

i. Proposal

The Commission proposed that, for purposes of the customer-specific order handling report required under proposed Rule 606(b)(3), the handling of an institutional order would include the handling of all smaller orders derived from the institutional order.[195]

ii. Final Rule and Response to Comments

The Commission is adopting this requirement as proposed. Any child orders derived from an order that is covered by Rule 606(b)(3) are also covered by the rule. Accordingly, Rule 606(b)(3) states that, for purposes of the customer-specific order handling report required under the rule, the handling of an NMS stock order submitted by a customer to a broker-dealer on a not held basis includes the handling of all child orders derived from that order.[196]

Thus, the broker-dealer is required to include any such child orders in the Rule 606(b)(3) customer-specific order handling report. For example, if a broker-dealer splits a

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195 See proposed Rule 606(b)(3). See Proposing Release, supra note 1, at 49448 for additional detail on the Commission's proposal.

196 See Rule 606(b)(3).

customer's not held NMS stock parent order into several child orders to be executed across different venues, the rule adopted today would require that the broker-dealer provide the required information regarding the execution of those child orders in the customer's Rule 606(b)(3) order handling report.

The Commission believes that such a result is consistent with the views of commenters. No commenter suggested that the Rule 606(b)(3) order handling report should not include child orders that were derived from a customer's parent order. To the contrary, several commenters suggested that it is essential that the broker-dealer order handling disclosures include the handling of all smaller (child) orders derived from the parent order.[197] In addition, several commenters noted that institutional investors often break up orders in a security across several broker-dealers, so that the aggregate may exceed $200,000 where the individual child orders do not.[198] The Commission believes that the rule adopted today addresses commenters' concerns regarding child orders by requiring the routing of any customer's not held NMS stock order and any child order derived therefrom, regardless of size or monetary value, to be included in the Rule 606(b)(3) order handling report (subject to the two de minimis exceptions) while at the same time achieving the Commission's stated goals.

4. Timing and Frequency Requirements for Customer-Specific Order Handling Report

a. Proposal

Proposed Rule 606(b)(3) required a broker-dealer to provide the customer-specific order handling report to the customer within seven business days of receiving the customer's request,

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197 See, e.g., Capital Group Letter at 4; FSR Letter at 4; SSGA Letter at 1; Citadel Letter at 2; Bloomberg Letter at 11; Dash Letter at 3; HMA Letter at 5-6; FIF Letter at 3-4, 17; FIF Addendum at 2.

198 See, e.g., Citadel Letter at 2; Bloomberg Letter at 11; Dash Letter at 3.

and required that the report contain information on the broker-dealer's handling of orders for that customer for the prior six months, broken down by calendar month.[199] To allow time for broker-dealers to develop the ability to produce such reports, the Commission stated that it would not require broker-dealers to produce Rule 606(b)(3) order handling reports containing information to cover months before broker-dealers are required to comply with Rule 606(b)(3), if adopted.[200]

b. Final Rule and Response to Comments

The Commission is adopting as proposed Rule 606(b)(3)'s requirement that a broker-dealer provide the customer-specific order handling report to the customer within seven business days of receiving the customer's request, and that the report contain information on the broker-dealer's handling of orders for that customer for the prior six months, broken down by calendar month.[201] The Commission received varied comments supporting certain aspects of the rule as proposed and other commenters suggesting different approaches. These comments and the Commission's responses on various aspects of the rule are discussed below.

Seven Business Days for Broker-Dealer to Respond to Customer Request. Two commenters believed that seven business days is a reasonable amount of time for a broker-dealer to respond to a customer's request to produce a monthly report.[202] One of those commenters also posited that, if the reports prove important to clients, they will likely be produced in shorter time-frames due to competitive forces.[203] Another commenter stated that 20 days to respond to a customer data request would be appropriate until generating portions of the Rule 606(b)(3)

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199 See proposed Rule 606(b)(3). See Proposing Release, supra note 1, at 49447-50 for additional detail on the Commission's proposal.

200 See Proposing Release, supra note 1, at 49448.

201 See Rule 606(b)(3).

202 See Capital Group Letter at 4; Markit Letter at 17.

203 See Markit Letter at 17.

reports and responding to customer requests is automated, and that upon automation and implementation of the program, the proposed seven days may be a reasonable period of time to respond.[204] Another commenter stated that seven business days may not be enough time to respond to a customer request, particularly since broker-dealers do not know how many customers will request the reports, and suggested that the seven-business day limit be removed.[205] Another commenter stated that seven days is not achievable if the customer request is made within the first half of the month because broker-dealers typically do not receive the rebate/fee information from an execution venue until the end of the first or second week of the month, and suggested that customer-level reports should not be required to be ready until the month following receipt of the fee/rebate information.[206] One commenter stated that, given that some broker-dealers offer fee pass-through arrangements (known as Cost-Plus), the commenter believed that the capabilities are in the industry to track net execution fee or rebate information.[207]

The Commission continues to believe, at this juncture, that it is appropriate to require a broker-dealer to provide the Rule 606(b)(3) report to a customer within seven business days of the customer's request. While Rule 606(b)(1) does not set forth a time limit for broker-dealers to respond to a customer's request for a report, the Rule 606(b)(1) disclosures are not as detailed as the disclosures set forth in Rule 606(b)(3). Furthermore, customers that submit not held NMS stock orders face a greater risk of information leakage than customers that submit held NMS stock orders. As a result, the Commission believes that requiring broker-dealers to respond

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204 See Bloomberg Letter at 15.

205 See Fidelity Letter at 4-5.

206 See FIF Letter at 17-18.

207 See HMA Letter at 11.

within seven business days is designed to ensure that customers receive the Rule 606(b)(3) disclosures in a manner that is timely enough to enable them to assess the risk of information leakage from how their orders are routed while still providing the broker-dealer with adequate time to prepare the report.

The Commission acknowledges, as noted in the Proposal, that broker-dealers will need to configure their systems to capture the information necessary to produce the Rule 606(b)(3) reports and, therefore, may not have the ability to produce historical reports about the routing of orders and executions that occurred before such systems are updated.[208] The Commission also notes that many broker-dealers' systems may already compile some of the order routing statistics required to be included in the Rule 606(b)(3) reports, thus mitigating to a degree the burden incurred by many broker-dealers in updating their systems and processes to be able to provide Rule 606(b)(3) reports to customers within seven business days. Further, the Commission has provided time between the effected date and the compliance date during which broker-dealers will be able to update their systems as necessary. Once such system updates are completed, the Commission expects broker-dealers to be able to generate the Rule 606(b)(3) reports in a largely automated fashion. As such, the Commission believes that the seven business day turnaround time will not be difficult for most broker-dealers to meet, and a longer time period for broker-dealers to respond is not necessary especially in light of the expected high level of automation for generating these reports.

Even though one commenter expressed concern that a seven business day response window would not be achievable because broker-dealers typically do not receive rebate/fee

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[208] See Proposing Release, supra note 1, at 49448. Broker-dealers are required to provide the Rule 606(b)(3) reports for dates going forward from the compliance date of this rulemaking and are not required to provide the reports for dates prior to the compliance date.

information from execution venues until the end of the first or second week of the following month, the Commission continues to believe that the seven business day timeframe is important in requiring that all customers receive their order handling information in a timeframe that will allow them to act in a timely fashion in response to the information contained in the report. Relatedly, the Commission notes that the six-month period covered by Rule 606(b)(3) is a six calendar month period.[209] Because there is no limit on the number of times that a customer may make a request for information under Rule 606(b)(3), the customer could subsequently make another request for information under Rule 606(b)(3) once the broker-dealer has obtained the fee/rebate information for the immediately preceding month.[210] Therefore, the Commission is not altering the seven business day time period for broker-dealers to respond to a customer request for the Rule 606(b)(3) disclosures.

Frequency of Responses to Requests for Rule 606(b)(3) Report. Two commenters believed that Rule 606(b)(3) does not need to specify the number of times that a broker-dealer is required to respond to a customer request for a report on order handling.[211] One of these commenters stated that the competitive dynamics of customer service in the free market should control and that, if the frequency of requests becomes a problem, the Commission can address this at a later date.[212] One commenter stated that broker-dealers should be required to provide

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209 Thus, for example, if a customer requests a Rule 606(b)(3) report during the month of July, the customer would be entitled (subject to the de minimis exceptions) to a report that covers the not held NMS stock orders it submitted to the broker-dealer during January through June, unless the broker-dealer does not yet have fee and rebate information for the month of June at the time of the customer's request, in which case the report would be required to cover the not held NMS stock orders that the customer submitted to the broker-dealer during December of the prior calendar year through May of the current calendar year.

210 In this scenario, the broker-dealer would be required to provide a Rule 606(b)(3) report covering the immediately preceding month if the customer's trading activity for the six month period including the immediately preceding month meets the customer-level de minimis threshold.

211 See Bloomberg Letter at 16; Markit Letter at 18.

212 See Bloomberg Letter at 16.

the proposed data on a weekly basis if requested by the customer, and that the timeframe for providing aggregated data should be no longer than monthly.[213]

Proposed Rule 606(b)(3) did not specify the number of times a broker-dealer is required to respond to a customer request for a report on order handling, and the Commission is not adopting any such specification in final Rule 606(b)(3). Consistent with the Commission's guidance in the Proposing Release, Rule 606(b)(3) does not limit the number of times that a customer may place a request for an order handling report and does not preclude a customer from making a standing request to its broker-dealer, whereby the customer would automatically receive a recurring report on a periodic basis without the need to make repeated requests.[214] Rule 606(b)(3) also does not require the broker-dealer to provide order handling information that is duplicative of information that the broker-dealer previously provided the customer pursuant to a prior request under the rule.[215] For example, if a broker-dealer provides a report to a customer for the prior six months, and that customer requests an additional report the following month, the broker-dealer would only need to provide a report for the latest month, subject to the customer-level de minimis threshold being met for the six month period that includes the latest month.

Six-Month Period Covered by the Report. One commenter stated that six months is a reasonable timeframe for broker-dealers to make historical data available for the Rule 606(b)(3) report, and suggested that historical data be retained at the broker-dealer for two years to fill any gaps in data collection from counterparties.[216] Another commenter suggested that the report

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213 See Capital Group Letter at 5.

214 See id. at 49448.

215 See id.

216 See Capital Group Letter at 4-5.

cover the previous quarter, not six months.[217] The Commission continues to believe that it is appropriate to require the Rule 606(b)(3) report to provide order handling data for a six-month period because it would provide customers with historical data to evaluate their broker-dealers' order routing practices to gauge the risk of information leakage and the potential for conflicts of interest. The Commission believes that a six-month period is reasonable to judge the performance of an execution venue, and the time period is long enough to offset any potential market moving event that may distort the data.[218] In addition, while one commenter requested a record retention period of two years for the Rule 606(b)(3) data, the Commission believes that such a retention period is unwarranted because the purpose of the Rule 606(b)(3) report is to provide customers with baseline information on a current or near-current basis that better enables them to understand how a broker-dealer is exercising discretion when routing their NMS stock orders. The purpose of the Rule 606(b)(3) report is not to enable a historical perspective on how broker-dealers routed orders. Moreover, broker-dealer order routing practices may be altered frequently, in connection with, among other things, an ever-evolving equity market structure, and so how a broker-dealer routed NMS stock orders more than six months prior to a request for a Rule 606(b)(3) report may not be consistent with the broker-dealer's more current routing practices. At the same time, if a Rule 606(b)(3) report is requested by a broker-dealer's customer, the broker-dealer is required to provide all of the information set forth in the rule, as applicable. As noted above, a broker-dealer is required to fulfill the customer's request with the most recent six months-worth of complete order handling information that the broker-dealer has already obtained at the time of the customer's request, subject to the de minimis exception.

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217 See Markit Letter at 16.

218 See Rule 606 Predecessor Adopting Release, supra note 7, at 75430 n.81.

Report Data Broken Down by Calendar Month. One commenter stated that broker-dealers should be required to provide the proposed data on a weekly basis if requested by the customer, and that this frequency of data would be most useful to firms, particularly if data is provided in eXtensible Markup Language ("XML") format.[219] This commenter also stated that the time frame for providing the data should be no longer than monthly. This commenter asserted that the Commission correctly noted in the Proposal that changes in fee structures at trading centers may affect a broker-dealer's routing decisions and that these fee changes mostly take place at the beginning of the month. According to this commenter, broker-dealers typically adjust mid-month to fee structure changes in order to meet targeted volume tiers that may have changed and having monthly data will enable a customer to monitor for such changes in order routing behavior.[220]

The Commission continues to believe that it is appropriate for the data in the Rule 606(b)(3) report to be broken down by calendar month. Consistent with this calendar month breakdown, as noted above, the six month period covered by the Rule 606(b)(3) report is a six calendar month period. Grouping the report data by calendar month should enable customers to assess how changes in fee structures at trading centers, which typically occur on a monthly basis, may affect a broker-dealer's routing decisions. Further, the Commission continues to believe that requiring the report data to be grouped by calendar month will help enable customers to assess how a broker-dealer's order handling practices may change in response to other internal or external factors. Grouping the data by calendar month allows a small aggregation of data, since it is possible that certain trading days may not yield any data points. Therefore, allowing

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219 See Capital Group Letter at 5.

220 See id.

grouping by calendar month may enable customers to evaluate the performance of their broker-dealers based on more meaningful data, and enable customers and broker-dealers to further discuss in a more meaningful manner how orders are routed and executed. The Commission does not believe that the rule should require a finer time period, such as weekly, as suggested by one commenter. The adopted rule does not limit what a customer may request from its broker-dealer, and in certain situations, a customer may request and receive weekly reports from its broker-dealer. The Commission believes that to require by rule a weekly report could increase compliance costs that may not be commensurate with the expected benefits. As such, the Commission does not believe that it is necessary to change the calendar month time period.

Annual Notice of Availability of Rule 606(b)(3) Report. Rule 606(b)(2) requires broker-dealers to notify customers in writing at least annually of the availability on request of the information specified in Rule 606(b)(1), and the Commission solicited comment as to whether the Commission should include a similar requirement for the new Rule 606(b)(3) disclosures. Four commenters stated that broker-dealers should not be required to provide an annual notice of the availability of the Rule 606(b)(3) report to institutional customers,[221] as institutional customers that do not request the report are unlikely to need it.[222] One commenter stated that institutional customers are sophisticated market participants who can best judge the type of information they need.[223] Accordingly, the Commission is not adopting an annual notification requirement with respect to the Rule 606(b)(3) reports.

Automatic Report to Customers. In the Proposing Release, the Commission noted that it considered an alternative to proposed Rule 606(b)(3) that would not require that customers

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221 See FIF Letter at 17; Fidelity Letter at 5; Bloomberg Letter at 15; Markit Letter at 17.

222 See Bloomberg Letter at 15; Fidelity Letter at 4.

223 See Fidelity Letter at 4.

request customer-specific standardized reports on order handling, but would instead require broker-dealers to provide them to customers automatically even in the absence of a customer request. The Commission also raised the notion of whether broker-dealers should be required to provide an internet portal where customers can view or download the reports.[224]

One commenter supported the Commission's proposed approach and stated that some institutional customers may request firm-specific customized reports and may not need the additional information in the order handling report.[225] Another commenter did not believe that the Commission should mandate delivery of the Rule 606(b)(3) order handling reports via internet portal.[226] Another commenter suggested that the process of sending reports to the customer should be automated such that it is emailed to the customer, either with a trade confirmation or on a periodic basis.[227] Two commenters stated that broker-dealers could make customer's data available via the internet for broker-dealers with customer-specific portals.[228] Another commenter stated that customer specific information should be sent periodically to investors, rather than on an ad hoc user-requested basis.[229]

The Commission is adopting as proposed the aspect of Rule 606(b)(3) that requires a broker-dealer to provide the order handling report upon customer request, and is not adopting any requirement regarding automatic provision of the report in the absence of a customer request or via an internet portal. Commenters that did support such automated delivery mechanisms did not provide a persuasive rationale for the Commission at this time to impose the likely cost to

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224 See Proposing Release, at 49501-02.

225 See Fidelity Letter at 4.

226 See Markit Letter at 18.

227 See Kohen Letter.

228 See Capital Group Letter at 4; FIF Letter at 18.

229 See HMA Letter at 8-10.

broker-dealers of developing such mechanisms. Not all customers may feel the need to request Rule 606(b)(3) reports from their broker-dealer, and as such it would not be a productive use of resources for broker-dealers automatically to provide reports to such customers. Moreover, under the adopted rule, a customer that wishes to receive the report can request it from the customer's broker-dealer. Mandating an automatic push to all customers would not be efficient, and could provide additional costs to broker-dealers. The Commission believes that the adopted rule strikes an appropriate balance between broker-dealers and customers, and does not believe that the rule should require the disclosure of order information when it is not requested by the customer. Likewise, customers that do request Rule 606(b)(3) reports may not desire to receive them via an internet portal, rendering the provision of internet portal access to such customers unnecessary.

5. Format of Customer-Specific Order Handling Reports

a. Breakdown by Order Routing Strategy Category at Each Venue

i. Proposal

The Commission proposed to require that the Rule 606(b)(3) order handling report be categorized by order routing strategy category for institutional orders for each venue.[230] The Commission proposed that order routing strategies be categorized into three general strategy categories for purposes of the Rule 606(b)(3) report: (1) a "passive order routing strategy," which emphasizes the minimization of price impact over the speed of execution of the entire institutional order; (2) a "neutral order routing strategy," which is relatively neutral between the minimization of price impact and speed of execution of the entire order; and (3) an "aggressive

[230] See proposed Rule 606(b)(3).

order routing strategy," which emphasizes speed of execution of the entire order over the minimization of price impact.[231]

ii. Final Rule and Response to Comments

The Commission is not adopting the proposed requirement that the Rule 606(b)(3) disclosures be categorized by order routing strategy for each venue to which the broker-dealer routed the customer's orders. The Commission received a significant amount of comment on this proposed requirement, nearly all of which expressed concern about, and none of which supported, the requirement as proposed. Commenters generally believed that the proposed categorization of the Rule 606(b)(3) order handling information for each venue by passive, neutral, or aggressive routing strategies category would be unnecessarily subjective and complex.[232] Several commenters stated that broker-dealers may categorize similar routing strategies differently, which could limit the utility and comparability of the reports.[233] Multiple commenters stated that the proposed strategies could be impacted by investor-specific customization.[234] In addition, several commenters stated that the proposed routing strategy categorization would be unworkable in light of the fact that trading algorithms may use multi-layered methodologies that would fit into more than one of the proposed categories,[235] and can

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231 See proposed Rule 606(b)(3)(v). See Proposing Release, supra note 1, at 49450-52 for additional detail on the Commission's proposal.

232 See, e.g., SIFMA Letter at 4; FIF Letter at 4, 15-16; FIF Addendum at 3; ICI Letter at 8; MFA Letter at 5; STA Letter at 5, 7-8; STA Letter II at 1; EMSAC Rule 606 Recommendations, supra note 16, at 3, 5.

233 See, e.g., SIFMA Letter at 4; FIF Letter at 4, 15-16; FIF Addendum at 3; MFA Letter at 5; Dash Letter at 6. One of these commenters agreed with the Commission's proposal to require broker-dealers to document their assignment of institutional orders to a particular routing strategy category, and suggested that the documentation be publicly available. See Dash Letter at 6-7.

234 See SIFMA Letter at 4; FIF Letter at 4; KCG Letter at 5-6; Markit Letter at 20.

235 See FIF Letter at 4, 15.

be dynamic and adjust to market conditions in real-time.[236] Commenters also asserted, broadly, that the proposed order routing strategy breakdown would be of little to no value to institutional investors.[237]

The Commission acknowledged in the Proposing Release that the proposed order routing strategy categorization had limitations similar to many of those raised by commenters, including the potential for inconsistency in how broker-dealers categorize an order routing strategy and reduced comparability of order handling reports across broker-dealers, mixed routing strategies that could reasonably fit into more than one category, and customers that provide specific or market condition-dependent order handling instructions to their broker-dealers that affect how a broker-dealer handles an institutional order.[238] The Commission preliminarily believed that such limitations would occur mainly at the margins, and that grouping order routing strategies into the three proposed categories would still allow for meaningful comparison of order handling practices across broker-dealers, and would allow customers to better evaluate a broker-dealer's order handling practices for orders that are handled using similar strategies.[239] In addition, a breakdown by routing strategy within each venue category was suggested by a group of commenters who submitted to the Commission, in advance of the Proposal, a proposed template for the customer-specific institutional order handling report.[240]

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236 See ICI Letter at 8; Capital Group Letter at 6; FIF Letter at 4, 15; MFA Letter at 5.

237 See Markit Letter at 20-22; STA Letter at 5; Fidelity Letter at 5, KCG Letter at 6. The Commission also received comment that suggested alternative methods to characterize order routing strategies or proposed breaking down the venue data by categories other than routing strategy, which the Commission is not adopting. See, e.g., MFA Letter at 5; Dash Letter at 6; HMA Letter at 10; HMA Letter II at 4; Better Markets Letter at 5; SIFMA Letter at 4-5; FIF Letter at 4; FIF Addendum at 3; ICI Letter at 8.

238 See Proposing Release, supra note 1, at 49451.

239 See id.

240 See Letter to Mary Jo White, Chair, Commission, from Dorothy M. Donohue, Deputy General Counsel, Investment Company Institute, Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, and Randy Snook, Executive Vice President, Securities Industry and

The comments received on this topic indicate, however, that interested market participants widely believe that the proposed order routing strategy categorization would not provide a sufficient benefit that justifies adopting the categorization notwithstanding its limitations. Commenters appear to believe that these limitations are more pervasive and potentially more deleterious to the quality and usefulness of the Rule 606(b)(3) order handling reports than the Commission preliminarily believed. Indeed, the Commission acknowledges that several commenters believed that the proposed order routing strategy categorization would not provide information to customers that is useful for assessing their broker-dealers' order handling performance and, in fact, could impair the utility and comparability of the Rule 606(b)(3) order handling reports. Accordingly, the Commission is persuaded not to include in final Rule 606(b)(3) the proposed order routing strategy categorization and therefore has not included proposed subparagraph (b)(3)(v) in the adopted rule.[241] Final Rule 606(b)(3) requires that the customer-specific order handling report categorize the data specified in subparagraphs (b)(3)(i) through (iv) for each venue to which the broker-dealer routed orders covered by the rule for the customer, without further categorization within each venue category.

As discussed infra,[242] the Commission believes that the order handling data points specified in subparagraphs (b)(3)(i) through (iv) of the rule, separated according to each venue to

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Financial Markets Association, dated October 23, 2014 ("Associations Letter"), available at http://www.sec.gov/comments/s7-02-10/s70210-428.pdf.

241 The Commission has not identified an appropriate alternative. The Commission believes that the commenters' suggestions such as categorizations based on "scheduled" versus "non-scheduled" distinctions, broker-dealers' intent, order types, or the state of the market, would all face similar issues as the originally proposed categorization because, as expressed in the comment letters, order routing strategies are difficult to place into well-defined categories due to the complex nature of today's order execution algorithms and smart order routing systems. The Commission believes that requiring categorization of order routing strategies could lead to inaccurate and potentially misleading disclosures.

242 See infra Section III.A.6.

which the broker-dealer routed orders for the customer, will provide the customer with sufficient information to evaluate its broker-dealer's routing performance and compare it to that of other broker-dealers. This data would also allow a customer to ascertain at a high level what type of routing strategies a broker-dealer may have utilized for the customer's not held NMS stock order flow. For example, as discussed infra,[243] subparagraphs (b)(3)(iii) and (iv) of Rule 606(b) require broker-dealers to disclose specific information regarding orders that provided liquidity and orders that removed liquidity, respectively. Orders that provided liquidity may reasonably be associated with routing strategies that operate more passively, while orders that remove liquidity may be associated with routing strategies that operate more aggressively. Even if such associations cannot be made reliably, however, the Commission believes that Rule 606(b)(3) is more likely to provide appropriate and useful order handling information, and information that is more uniform across broker-dealers and therefore more likely to facilitate comparisons across broker-dealers, by requiring that the information specified in subparagraphs (b)(3)(i) through (iv) be separated for each venue to which the broker-dealer routed orders for the customer without further categorization within each venue category. The requirements of Rule 606(b)(3) provide a standardized baseline of customer-specific order handling disclosures, and customers remain free to negotiate for additional disclosures or categorizations, such as categorizations by routing strategy, with their broker-dealers if they so desire.

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243 See id.

b. Segregation of Directed Orders and Non-Directed Orders

i. Proposal

The Commission did not propose to require that the Rule 606(b)(3) customer-specific order handling report differentiate between orders that the customer directed the broker-dealer to route to a particular venue versus orders that the customer did not so direct.

ii. Final Rule and Response to Comments

Several commenters suggested that directed orders and non-directed orders be segregated in the Rule 606(b)(3) order handling reports. As noted above, several commenters asserted that the disclosures in the Rule 606(b)(3) reports would be most useful to customers if they are focused on orders for which the broker-dealer exercised discretion in handling.[244] In addition, commenters suggested that directed orders be clearly segregated in the reports from orders that were routed according to the broker-dealer's default routing behavior, otherwise the broker-dealer's normal routing behavior could be misrepresented.[245] One commenter requested that directed orders be included, but as a separate category, in Rule 606 reports in order to expand the universe of covered orders.[246]

The Commission is modifying Rule 606(b)(3) to require that the customer-specific order handling report for not held NMS stock orders be divided into separate sections for the customer's directed orders and non-directed orders, with each section containing the disclosures regarding the customer's order flow with the broker-dealer specified in Rule 606(b)(3), as well as the disclosures for each venue to which the broker-dealer routed orders specified in Rules 606(b)(3)(i)-(iv). The two types of orders are fundamentally different in that, with directed

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244 See supra Section 0.A.1.0.0. See also Bloomberg Letter at; Markit Letter at 8; STA Letter at 6.

245 See FIF Letter at 5; Better Markets Letter at 5-6.

246 See HMA Letter at 3.

orders, the customer directs the broker-dealer to route its orders to a particular venue, whereas the broker-dealer exercises discretion in determining where to route and execute the customer's non-directed orders. Segregating directed not held orders from non-directed not held orders in the customer-specific report would provide a customer with one report that reflects all of its not held NMS stock orders handled by the broker-dealer while separately providing disclosures for orders for which the broker-dealer exercises venue routing discretion.

By providing the order handling information separately for non-directed not held orders, the Rule 606(b)(3) report will provide a customer with a more precise reflection of how and where its broker-dealer is routing the customer's not held NMS stock orders pursuant to the discretion afforded to the broker-dealer. A primary utility of the Rule 606(b)(3) reports is to enable customers to better understand how their broker-dealers exercise discretion in handling their not held orders, and this will be more easily achieved if the reported disclosures for directed and non-directed orders are separate. Otherwise, with directed not held orders and non-directed not held orders commingled in the report, a customer may not be able to accurately differentiate routing behavior for which its broker-dealer exercised discretion in determining where to route an order from routing behavior where the customer itself directed the routing destination. Separating the Rule 606(b)(3) order handling disclosures for non-directed not held orders from those for directed not held orders should help customers evaluate their broker-dealers order handling performance and how their broker-dealers are achieving best execution for their non-directed not held orders while managing the potential impact of information leakage and conflicts of interest.

In addition, the Commission believes that customers will benefit from being able to analyze Rule 606(b)(3) routing disclosures that are specific to their directed not held orders for

NMS stock. As discussed below, the Rule 606(b)(3) reports require the broker-dealer to disclose, among other things, information on order execution.[247] This information would be relevant to a customer assessing its broker-dealer's execution of its directed not held orders, including a customer interested in validating that its broker-dealer is routing its directed not held orders consistent with the customer's instructions.

c. XML Format and Standardization

i. Proposal

The Commission proposed to require that the customer-specific order handling report required under proposed Rule 606(b)(3) be made available using an XML schema and associated PDF renderer published on the Commission's website.[248] To provide a standardized presentation for the report, the Commission also proposed a chart form for the report's required disclosures of information regarding orders that a broker-dealer executes internally or routes to other venues.[249] Specifically, the Commission proposed to require that each report contain rows that would be categorized by venue and by order routing strategy category for each venue,[250] with certain columns of information for each of the required rows.[251] Thus, as proposed, each report would

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247 See infra Section 0.A.0.

248 See proposed Rule 606(b)(3). The Commission's schema is a set of custom XML tags and XML restrictions designed by the Commission to reflect the proposed disclosures in Rule 606. XML enables data to be defined, or "tagged," using standard definitions. The tags establish a consistent structure of identity and context. This consistent structure can be automatically recognized and processed by a variety of software applications such as databases, financial reporting systems, and spreadsheets, and then made immediately available to the end-user to search, aggregate, compare, and analyze. In addition, the XML schema could be easily updated to reflect any changes to the open standard. XML and PDF are "open standards," which is a term that is generally applied to technological specifications that are widely available to the public, royalty-free, at no cost.

249 See Proposing Release, supra note 1, at 49450. The Commission also noted that, for purposes of the Rule 606(b)(3) order handling report, a venue would be any trading center to which an order is routed or where an order is executed. See Rule 600(b)(78); Proposing Release, supra note 1, at 49450.

250 See proposed Rule 606(b)(3); see also Proposing Release, supra note 1, at 49450.

251 See proposed Rule 606(b)(3)(i) through (iv); see also Proposing Release, supra note 1, at 49450.

have been formatted so that a customer would be readily able to observe its order activity at a particular venue, as further subdivided by order routing strategy category for that venue.[252]

The Commission also proposed new format requirements for the existing customer-specific order handling disclosures in Rule 606(b)(1). Specifically, the Commission proposed to require that the customer-specific order routing report required by Rule 606(b)(1) be made available using an XML schema and associated PDF renderer published on the Commission's website. [253]

ii. Final Rule and Response to Comments

The Commission is adopting as proposed the requirement that the customer-specific order handling report required under Rule 606(b)(3) be made available using an XML schema and associated PDF renderer published on the Commission's website.[254]

The Commission received several comments on the proposed reporting format,[255] with a number of commenters supporting a machine-readable or standardized format[256] or XML in particular,[257] and other commenters criticizing the proposed use of XML and a PDF renderer and suggesting different formats such as JavaScript Object Notation ("JSON"), comma-separated values ("CSV"), spreadsheet, or flat text.[258]

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252 See Proposing Release, supra note 1, at 49450.

253 See proposed Rule 606(b)(1). See Proposing Release, supra note 1, at 49448-51 for additional detail on the Commission's proposal.

254 See Rule 606(b)(3).

255 See Capital Group Letter at 4; Kohen Letter; HMA Letter at 12; Better Markets Letter at 2; FIF Letter at 17; Markit Letter at 17; CFA Letter at 11; FIA Letter at 2; Thomson Reuters Letter at 2.

256 See, e.g., HMA Letter at 12; Markit Letter at 17.

257 See, e.g., Capital Group Letter at 4; Better Markets Letter at 2; FIF Letter at 17; FIA Letter at 2.

258 See HMA Letter at 12; Markit Letter at 17; Kohen Letter.

The Commission believes that while XML predates JSON as a standard, XML has proven to be a flexible standard that continues to be incorporated into common desktop applications and is the basis for a variety of financial reporting languages in a way that JSON is not. Moreover, if the Commission did not specify a particular format and instead left it to the discretion of the filer, users of the data would lose their ability to compare the data easily and easily ensure their consistency between filers. XML's Schema is a widely used, stable metadata standard which is better suited for validation than JSON. Validations help ensure data consistency and comparability, which enhances overall data quality for both broker-dealers and customers. Market participants have the necessary tools and experience with analyzing a variety of financial data in the XML format. The use of XML has been adopted in a number of recent Commission rulemakings[259] and the Proposal to use an XML format here was supported by a number of commenters.[260]

As for the suggestions to adopt a CSV, spreadsheet file, or flat-text file format, the Commission does not believe that these formats would be as suitable as XML, since the hierarchical nature of the disclosures required by the amendments being adopted today would require more than a single set of uniformly structured rows, and these formats would not support representing such disclosures easily. Moreover, neither of those formats can incorporate robust validations to address issues such as completeness, required relationships, and correct formatting. If used, a CSV, spreadsheet, or flat text file format would likely have data quality issues of consistency and comparability that would make the data less usable and require repeated

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259 See, e.g., Securities Exchange Act Release Nos. 79095, 81 FR 81870 (November 18, 2016) (adopting Investment Company Reporting Modernization); 74246, 80 FR 14437 (March 19, 2015) (adopting Security-Based Swap Data Repository Registration, Duties, and Core Principles); 72982 (September 4, 2014), 79 FR 57183 (September 24, 2014) (adopting Asset-Backed Securities Disclosure and Registration).

260 See, e.g., Capital Group Letter at 4; Better Markets Letter at 2; FIF Letter at 17; CFA Letter at 11.

corrections by the broker-dealers. Accordingly, the Commission is adopting as proposed the requirement that the customer-specific order handling report be made available using an XML schema to be published on the Commission's website.

While one commenter criticized the use of the PDF renderer, that commenter criticized its use because PDF files cannot be processed and analyzed.[261] The Commission notes, however, that the rule, as amended, requires that the data be provided "using the most recent versions of the XML schema and the associated PDF renderer" (emphasis added). The PDF file and underlying data in an XML format both will be required. The requirement to use the Commission's XML schema is designed to ensure that the data is provided in an XML format that is structured and machine-readable, so that the data can be more easily processed and analyzed. As a result, all data that would appear in a PDF file would be required to have a corresponding file provided in XML that has been used to generate the PDF file using the renderer. The Commission received no other comments opposing the Proposal to require that the reports be provided in a human-readable format through the use of a PDF renderer, and one commenter supported requiring a human-readable format.[262] The Commission continues to believe that the reports should be provided in a human-readable format for those customers that prefer only to review individual reports and not necessarily aggregate or conduct large-scale data analysis on the data. The Commission believes that by requiring use of the associated PDF renderer published on the Commission's website, the XML data would be instantly presentable in a human-readable PDF format and consistently presented across reports. Accordingly, the Commission is adopting as proposed the requirements that the customer-specific order handling

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261 See Kohen Letter.

262 See Markit Letter at 28.

report be made available using an XML schema and associated PDF renderer published on the Commission's website.

One commenter suggested that the Commission should add headers to rows and columns in the customer-specific report that explains what each category of information means,[263] and another commenter stated that the fields in the report should be explicitly defined.[264] For purposes here, the Commission assumes that the latter comment pertains to defining the terms used in Rule 606(b)(3)(i) through (iv). No commenters stated that any of the undefined terms in proposed Rule 606(b)(3)(i) through (iv) were unclear or inconsistent or would otherwise impede comparability, and the Commission believes that adding headers and definitions may result in unnecessary confusion and complexity. Accordingly, the Commission is not adopting definitional headers for the customer-specific reports and is not adopting definitions for the terms used in proposed Rule 606(b)(3)(i) through (iv). The Commission is adopting as proposed the chart form for the required disclosures set forth in Rule 606(b)(3)(i) through (iv).[265]

The Commission also is adopting as proposed the requirement that the customer-specific order handling report required under Rule 606(b)(1) be made available using an XML schema and associated PDF renderer published on the Commission's website.[266] The Commission believes that providing the customer-specific Rule 606(b)(1) reports in the proposed XML/PDF format will promote the consistency and comparability of the reports. The Commission received two comments specifically questioning the need for providing such reports in the proposed XML/PDF format, stating that customers rarely request these reports, and stating their view that

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263 See CFA Letter at 10-11.

264 See FIF Letter at 17.

265 See Rule 606(b)(3).

266 See Rule 606(b)(1).

the cost of implementing the proposed format would outweigh the benefits.[267] As discussed above, the Commission is amending the categories of orders to which the existing disclosure requirements of Rule 606(b)(1) apply to include orders in NMS stock that are submitted on a not held basis and for which the broker-dealer is not required to provide the customer a report under Rule 606(b)(3).[268] The Commission believes that customers that submit orders on a not held basis that are not entitled to receive the disclosures required by Rule 606(b)(3) may still analyze and compare the data they receive under Rule 606(b)(1) and engage in informed discussions with their broker-dealers about the broker-dealer's order handling practices. The use of the XML/PDF format will enable those customers to more easily analyze and compare the individualized data provided.

6. Rule 606(b)(3) Report Content

a. Information on the Customer's Order Flow With the Reporting Broker-Dealer

i. Proposal

The Commission proposed that the Rule 606(b)(3) order handling report include information on the order flow sent by the customer to the broker-dealer. Specifically, the Commission proposed to require disclosure of: (1) total number of shares of orders sent to the broker-dealer by the customer during the reporting period; (2) total number of shares executed by the broker-dealer as principal for its own account; (3) total number of orders exposed by the broker-dealer through an actionable IOI; and (4) venue or venues to which orders were exposed by the broker-dealer through an actionable IOI.[269]

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267 See Thomson Reuters Letter at 2; FIF Letter at 9, 12.

268 See supra Section 0.A.0.0.0.

269 See proposed Rule 606(b)(3). See Proposing Release, supra note 1, at 49452-54 for additional detail on the Commission's proposal.

ii. Final Rule and Response to Comments

The Commission is adopting, with certain modifications, the requirement that the Rule 606(b)(3) order handling report include information on the customer's not held NMS stock order flow with the broker-dealer. The Commission believes that this information would be useful for customers to evaluate their not held order flow with a particular broker-dealer during the reporting period, the broker-dealer's methods for achieving best execution for such order flow, and the potential for conflicts of interests and information leakage associated with such methods. Specifically, the Commission is adopting as proposed the requirement that the Rule 606(b)(3) report disclose the total number of shares of not held NMS stock orders sent to the broker-dealer by the customer during the reporting period, as well as the requirement that the Rule 606(b)(3) report disclose the total number of shares executed by the broker-dealer as principal for its own account.[270] One commenter expressed support for these requirements.[271] The Commission continues to believe that the information would be useful to customers in understanding how much of their not held order flow was handled by a particular broker-dealer during the reporting period, which should help customers make comparisons across broker-dealers, as well as how often a particular broker-dealer trades against the customers' not held orders, which is relevant information to customers assessing their broker-dealers' compliance with best execution obligations and potential conflicts of interest that their broker-dealers face when trading as principal.

The Commission also is adopting the requirement that the Rule 606(b)(3) report disclose the total number of not held NMS stock orders exposed by the broker-dealer through actionable

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[270] See Rule 606(b)(3).

[271] See Markit Letter at 22.

IOIs. One commenter expressed support for this requirement.[272] The Commission continues to believe that that identifying the total number of not held NMS stock orders exposed by a broker-dealer though actionable IOIs should give customers a more complete view of how their broker-dealers handle their not held orders and allow them to better evaluate how their broker-dealer manages information leakage.

The Commission is adopting, with modifications discussed below, the requirement that broker-dealers disclose the venue(s) to which not held NMS stock orders were exposed by the broker-dealer through an actionable IOI. The Commission continues to believe that disclosure of the specific venue(s) to which a broker-dealer exposed such an order by an actionable IOI would be useful for the customer to further assess the extent, if any, of information leakage of their not held orders and potential conflicts of interest facing their broker-dealers. Specifically, the Commission believes that such information will enable customers to assess whether their broker-dealers are exposing their not held orders to select market participants with which the broker-dealer has affiliations or business relationships, or from which the broker-dealer receives other incentives. In addition, the Commission believes that disclosure of this information will provide the customer with a more complete understanding of the broker-dealer's order handling activities for purposes of assessing the broker-dealer's execution quality generally.

Commenters generally supported requiring a broker-dealer to identify the venue(s) that were sent actionable IOIs.[273] One commenter expressed broad support for requiring a broker-dealer to identify for customers the total number of orders exposed, and the venue(s) to which

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272 See id. at 23.

273 See HMA Letter at 10; NYSE Letter at 1-2; Markit Letter at 4, 11-12; FIF Letter at 7; Fidelity Letter at 4; STA Letter II at 3.

orders were exposed, through actionable IOIs.[274] This commenter also stated that the venue information is necessary for an institution to evaluate the exposure of its orders through actionable IOIs for information leakage and conflicts of interest.[275]

Some commenters suggested that the Commission should clarify that the reference in proposed Rule 606(b)(3) to the venue(s) to which not held NMS stock orders were exposed by the broker-dealer through an actionable IOI does not include IOIs that a broker-dealer may send to its institutional customers.[276] They stated that including broker-dealers' institutional customers as "venues" under the rule would be problematic from a competitive perspective, as broker-dealers would be required to disclose their customer lists, and many customers likely would not want their identities to be disclosed.[277] Some of these commenters suggested that, to effectuate the suggested clarification, the Commission should require disclosure of actionable IOI information only with respect to actionable IOIs sent to "market centers" as defined in Rule 600(b)(38), which would not include broker-dealers' customers.[278]

The Commission's reference to "venues" for purposes of Rule 606(b)(3) is meant to refer to external liquidity providers to which the broker-dealer may send actionable IOIs. To provide the clarity requested by commenters, the Commission intends in this context for these external liquidity providers generally to include market participants that operate a business of providing liquidity by buying and selling securities for their own account and seek to profit from the spread between such trades, and that may reasonably be assumed by a broker-dealer to be willing to

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274 See NYSE Letter at 1.

275 See id. at 2.

276 See Markit Letter at 4, 11-12; FIF Letter at 7; Fidelity Letter at 4; STA Letter II at 3.

277 See Market Letter at 12; FIF Letter at 7; Fidelity Letter at 4; STA Letter II at 3.

278 17 CFR 242.600(b)(38). See FIF Letter at 7; FIF Addendum at 4 n.7; Fidelity Letter at 4; STA Letter II at 3.

take the opposite side of a trade in connection with that business. The Commission believes that this category of market participants likely would include market centers as defined in Rule 600(b)(38), but may not be limited to such market centers. For example, as noted above, for purposes of Rule 606(b)(3), the Commission believes that the venues referenced by Rule 606(b)(3) generally would include an external liquidity provider that trades proprietarily. Rule 600(b)(38) defines market centers to include OTC market makers, among other things. In this context, an external liquidity provider that trades proprietarily, and to which a broker-dealer sends an actionable IOI, may be an OTC market maker and thus a market center under Rule 600(b)(38). But even if such an external liquidity provider is not an OTC market maker and does not qualify as a market center under Rule 600(b)(38), the Commission generally would consider a venue to be covered by Rule 606(b)(3) if it operates a business of providing liquidity by buying and selling securities for its own account and seeks to profit from the spread from such trades, and may reasonably be assumed by a broker-dealer to be willing to take the opposite side of a trade in connection with that business.

The Commission has considered commenters' concerns regarding the potential disclosure of customer identities if customers to which broker-dealers send actionable IOIs are "venues" under the rule. The Commission believes that it is appropriate to protect the confidentiality of broker-dealer customer information, which can be proprietary. At the same time, the Commission believes that it is important for a customer to receive detailed, standardized disclosures from its broker-dealer that enable the customer to better evaluate the broker-dealer's handling of its not held NMS stock orders. If a broker-dealer exposes a customer's not held NMS stock order to one or more of its other customers via an actionable IOI, the customer should be entitled to that information as it may inform its assessment of its broker-dealer's

performance in handling its orders. Accordingly, the Commission is adopting a modification to Rule 606(b)(3) that requires broker-dealers to disclose the fact that actionable IOIs were sent to other customers, but not the identity of such customers. The Commission believes that this approach strikes an appropriate balance between protecting the identities of broker-dealers' customers and sufficient and meaningful disclosure to customers of the venues to which broker-dealers expose their not held NMS stock orders through actionable IOIs. Thus, in pertinent part, final Rule 606(b)(3) requires that the broker-dealer's customer-specific order handling report include the venue(s) to which not held NMS stock orders were exposed by the broker-dealer through an actionable IOI provided that, where applicable, a broker-dealer must disclose that it exposed a customer's order through an actionable IOI to other customers but need not disclose the identity of such customers.[279] In other words, where a broker-dealer exposes a customer's not held NMS stock order through an actionable IOI to a venue that is a person or entity that may place an order, such as another of the broker-dealer's customers, the broker-dealer's disclosure in the Rule 606(b)(3) report with respect to this exposure may be aggregated and anonymized, and simply state that the customer's order was exposed to other customers of the broker-dealer via an actionable IOI.

One commenter suggested that IOIs should be reported separately from orders.[280] This commenter stated that the execution quality and routing characteristics of IOIs are fundamentally different from normal parent and child orders, and must be reported separately for investors to properly analyze how orders are being handled; otherwise, according to this commenter, the IOIs

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279 See Rule 606(b)(3).

280 See HMA Letter at 10.

could generate potentially misleading information.[281] Consistent with this comment and what was proposed, actionable IOIs are required to be reported separately under Rule 606(b)(3). Specifically, with respect to the order flow sent by the customer to the broker-dealer, Rule 606(b)(3) requires disclosure of, among other things: the total number of not held NMS stock orders exposed by the broker-dealer through an actionable IOI and the venue or venues to which such orders were exposed by the broker-dealer through an actionable IOI. These are the only disclosures for actionable IOIs under Rule 606(b)(3), and each such disclosure must be set forth separately in the Rule 606(b)(3) report. The other Rule 606(b)(3) disclosures pertain to customers' not held NMS stock orders (and any child orders derived therefrom). They are distinct from the actionable IOI disclosures, and they generally should not include actionable IOIs in the reported information.

Finally, one commenter stated that Rule 606 should require disclosure of routing statistics in response to IOIs received by smart order routers.[282] According to this commenter, many smart order routers accept IOIs and use them to make routing decisions, while few smart order routers send IOIs. This commenter suggested that the amendments to Rule 606 should require disclosure of routing statistics in response to IOIs received by SORs including the fill rates on orders sent to external liquidity providers or other venues, categorized by the receipt of a contra-side IOI or not.[283]

As the commenter acknowledged, Rule 606(b)(3) focuses on requiring the disclosure of IOIs sent by routing broker-dealers on behalf of orders received from their customers, not of IOIs

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281 See id.

282 See Markit Letter at 4, 11-12, 23, 34.

283 See id. at 23.

received by broker-dealers.[284] The Commission, at this time, intends to maintain the focus of the rule's disclosure requirement for actionable IOIs on IOIs sent by the broker-dealer. The required disclosures are intended to be a baseline from which customers can, if they so choose, negotiate with their broker-dealers for further data. The Commission believes that such a baseline is provided, with respect to actionable IOIs, through requiring disclosure of the actionable IOIs sent by a broker-dealer on behalf of an order received from its customer. The Commission also believes that this information would provide an adequate basis for customers to assess the extent, if any, of information leakage of their orders and potential conflicts of interest facing their broker-dealers, as well as enable such customers to assess whether their broker-dealers are exposing their orders to select market participants with which the broker-dealer has affiliations or business relationships, or from which the broker-dealer receives other incentives. The Commission does not believe, at this juncture, that also including disclosures related to IOIs received by broker-dealers would provide significantly more useful information to customers in making those assessments with respect to their broker-dealers.

Accordingly, Rule 606(b)(3) requires, with respect to the not held NMS stock order flow sent by the customer to the broker-dealer, the total number of shares of orders sent to the broker-dealer by the customer during the relevant period; the total number of shares executed by the broker-dealer as principal for its own account; the total number of orders exposed by the broker-dealer through an actionable indication of interest; and the venue or venues to which orders were exposed by the broker-dealer through an actionable indication of interest, provided that the

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[284] See id. at 12.

identity of such venue or venues may be anonymized if the venue is a person or entity that may place an order with the broker-dealer.[285]

b. Information For Each Venue to Which the Broker-Dealer Routed Orders For the Customer

i. Proposal

The Commission proposed that the customer-specific order handling report required under proposed Rule 606(b)(3) include specific columns of information for each venue to which the broker-dealer routed orders for the customer, in the aggregate and broken down by passive, medium, and aggressive order routing strategies.[286] The proposed rule identified four categories of such information: information on order routing, information on order execution, information on orders that provided liquidity, and information on orders that removed liquidity.[287]

Information on Order Routing. With respect to information on order routing, the Commission proposed to require, within each venue and order routing strategy category, disclosure of: (1) total shares routed; (2) total shares routed marked immediate or cancel;[288] (3) total shares routed that were further routable; and (4) average order size routed.[289]

Information on Order Execution. With respect to information on order execution, the Commission proposed to require disclosure of: (1) total shares executed; (2) fill rate;[290] (3) average fill size;[291] (4) average net execution fee or rebate;[292] (5) total number of shares executed

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285 See Rule 606(b)(3).

286 See proposed Rule 606(b)(3). As discussed above, the Commission is not adopting the proposed order routing strategy categorization. See supra Section 0.A.0.0.

287 See proposed Rule 606(b)(3)(i) through (iv). See also Proposing Release, supra note 1, at 49453-58 for additional detail on the Commission's proposal.

288 See Proposing Release, supra note 1, at 49453.

289 See proposed Rule 606(b)(3)(i). See also Proposing Release, supra note 1, at 49453-54.

290 Fill rate would be calculated by the shares executed divided by the shares routed.

291 Average fill size would be the average size, by number of shares, of each order executed on the venue.

at the midpoint;[293] (6) percentage of shares executed at the midpoint; (7) total number of shares executed that were priced on the side of the spread more favorable to the order; (8) percentage of total shares executed that were priced on the side of the spread more favorable to the order; (9) total number of shares executed that were priced on the side of the spread less favorable to the order; and (10) percentage of total shares executed that were priced on the side of the spread less favorable to the order.[294]

Information on Orders that Provided Liquidity. In addition to the order routing and execution data described above, the Commission proposed to require disclosure of information on orders that provided liquidity.[295] Specifically, the Commission proposed to require disclosure of: (1) total number of shares executed of orders providing liquidity; (2) percentage of shares executed of orders providing liquidity; (3) average time between order entry and execution or cancellation for orders providing liquidity (in milliseconds); and (4) the average net execution rebate or fee for shares of orders providing liquidity (cents per 100 shares, specified to four decimal places).[296] In connection with this new proposed requirement, the Commission proposed to define the term "orders providing liquidity" to mean "orders that were executed against after resting at a trading center."[297]

Information on Orders that Removed Liquidity. Similar to orders that provided liquidity, the Commission proposed to require the disclosure of information on orders that removed

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292 The fee and rebate would be measured in cents per 100 shares, specified to four decimal places.

293 The midpoint would be the price halfway between the national best bid and national best offer.

294 See proposed Rule 606(b)(3)(ii). See also Proposing Release, supra note 1, at 49454-55.

295 See proposed Rule 606(b)(3)(iii).

296 See id. See also Proposing Release, supra note 1, at 49456.

297 See proposed Rule 600(b)(58).

liquidity.[298] Specifically, the Commission proposed to require disclosure of: (1) total number of shares executed of orders removing liquidity; (2) percentage of shares executed of orders removing liquidity; and (3) average net execution fee or rebate for shares of orders removing liquidity (cents per 100 shares, specified to four decimal places).[299] Relatedly, the Commission also proposed to define the term "orders removing liquidity" as "orders that executed against resting trading interest at a trading center."[300]

ii. Final Rule and Response to Comments

The Commission is adopting as proposed the requirement that the Rule 606(b)(3) customer-specific order handling report include specific columns of information for each venue to which the broker-dealer routed orders for the customer,[301] and is adopting as proposed the specific pieces of information set forth in Rules 606(b)(3)(i) through (iv) that are required to be included in the reports.[302] Specifically, the Commission is adopting as proposed the required data points for information on order routing specified in Rule 606(b)(3)(i), for information on order execution specified in Rule 606(b)(3)(ii), for information on orders that provided liquidity specified in Rule 606(b)(3)(iii), and for information on orders that removed liquidity specified in

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298 See proposed Rule 606(b)(3)(iv).

299 See proposed Rule 606(b)(3)(iv)(A) through (C). See also Proposing Release, supra note 1, at 49458.

300 See proposed Rule 600(b)(56).

301 See Rule 606(b)(3). As discussed above, the Commission is making two modifications to the format of the Rule 606(b)(3). First, the Commission is not adopting the proposed order routing strategy categorization. See supra Section 0.A.0.0. Second, the Commission is requiring that the Rule 606(b)(3) report be divided into two separate sections – one for directed orders and the other for non-directed orders. See Section III.A.0.0. The Commission also is revising the Rule 600(b) definitions of the terms "directed order" and "non-directed order." See id.; see also supra Section 0.A.1.b.0.

302 See Rule 606(b)(3).

Rule 606(b)(iv).[303] The Commission also is adopting as proposed the definitions of the terms "orders providing liquidity" and "orders removing liquidity."

Commenters broadly supported the Proposal to require broker-dealers to provide more detailed order handling information to their customers upon request, and expressed varied views on what specific or additional metrics would be most useful and should be included in the report. Some commenters suggested requiring additional execution quality-related metrics in Rule 606(b)(3),[304] such as: a spread capture metric that measures the execution price relative to the NBBO or displayed quote,[305] information concerning the realized spread and the effective spread and quoted spread percentages,[306] price improvement statistics,[307] average time between order entry and execution or cancellation for orders that remove liquidity,[308] and median order size routed and median fill size.[309] Other comments related to fee and rebate disclosures. Specifically, some commenters suggested revising the data points in Rule 606(b)(3) by requiring an estimate of execution fees and rebate information.[310] One commenter asserted that the fee and rebate disclosures in proposed Rule 606(b)(3)(iv) lack actionable data, and recommended a

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303 See id.

304 See, e.g., HMA Letter at 4, 11; ICI Letter at 9-10; Markit Letter at 8-10, 24-26, Appendix A.

305 See, e.g., HMA Letter at 11; ICI Letter at 9; BlackRock Letter at 2. https://fif.com/images/Retail_Execution_Quality_Statistics/FIF_Rule_605-606_WG_-_Retail_Execution_Quality_Stats_Wholesaler_Template.pdf).

306 See, e.g., BlackRock Letter at 2; Markit Letter at 24.

307 See, e.g., ICI Letter at 9; Markit Letter at 24.

308 See, e.g., FSR Letter at 6; ICI Letter at 10.

309 See Capital Group Letter at 6.

310 See Fidelity Letter at 5; Markit Letter at 16 and n.37, 25. One of these commenters also sought clarity as to what fee a broker should use if a broker executes a trade on its own ATS. See Fidelity Letter at 5. Rules 606(b)(3(ii) through (iv) requires the broker-dealer to disclose the average net execution fees or rebates. Thus, the Commission believes that a broker generally would need to disclose this information to the extent relevant to execution of a trade on its own ATS. If the broker incurs no fee or rebate for such an execution, then that is what should be disclosed.

completely revised version of the Rule 606(b)(3) report.[311] Another commenter, by contrast, supported disclosure of the net execution fee or rebate and believed that broker-dealers have the capability to track this information.[312] Another commenter suggested that broker-dealers should disclose to institutional (and retail) customers the nature of payment for order flow and profit-sharing relationships, including whether or not they pass any of the rebates or order-flow payments to their customers, as well as additional information that the commenter asserted is designed to help investors understand the state of the market at the time of execution and whether the broker-dealer was using a venue in which there is a conflict of interest or economic routing inducement.[313] One commenter believed that the Proposal does not address the economic pressures or transaction-based costs incurred by the broker-dealer prior to receiving the order, particularly in light of broker-dealer use of order management systems ("OMSs") and fees associated with OMSs and connectivity, and suggested that broker-dealers be required to disclose such fees to their customers.[314] Finally, some commenters suggested requiring execution venues to provide standard liquidity indicators to broker-dealers,[315] and one commenter broadly recommended that the Rule 606(b)(3) order handling disclosures build off

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311 See Markit Letter at 8-10, Appendix A.

312 See HMA Letter at 11.

313 See Better Markets Letter at 7-8. This commenter also stated that, while broker-dealers are under "best execution" obligations, venues they route their orders to (which may themselves re-route to other venues) are not subject to the same obligations, and that the Commission should harmonize the duties of care. See id. The Commission notes that harmonization of duties of best execution and care across venues and broker-dealers is outside the scope of this rulemaking.

314 See Bloomberg Letter at 2-7. This commenter also contended that the Proposal is predicated on positions regarding depth of book data and a broker-dealer's duty of best execution that are odds with an Initial Decision in a Commission Administrative Proceeding, and that the Commission should address the fees charged by exchanges for their market data products. See id. at 2-3, 7-11. The Commission separately has issued an order dated October 16, 2018. See Securities Exchange Act Release No. 84432 (October 16, 2018), available at https://www.sec.gov/litigation/opinions/2018/34-84432.pdf.

315 See Fidelity Letter at 5; Thomson Reuters Letter at 2.

the FIX Trading Community's FIX Execution Venue Reporting Recommended Best Practices in order to achieve standardization and objectivity in the disclosures.[316]

While commenters suggested different order handling metrics that could be useful to customers and provide more in-depth insight into how broker-dealers handle not held NMS stock orders, the Commission's intent in establishing the Rule 606(b)(3) disclosures is not to require broker-dealers to provide every specific piece of data that may be available for an order and potentially valuable to certain customers. Rather, the Commission's intent is to provide a baseline of standardized order handling information that (subject to two de minimis exceptions) all customers that submit not held NMS stock orders to broker-dealers are entitled to receive from their broker-dealers and that customers can use to evaluate their broker-dealers' order handling performance. Rules 606(b)(3)(i) through (iv) require broker-dealers to provide detailed information regarding order routing, order execution, orders that provided liquidity, and orders that removed liquidity. Each of those four categories of information is further divided into several subcategories of specific pieces of data that must be disclosed. The Commission continues to believe that these data points are sufficient to provide the Commission's intended baseline, standardized set of information that customers can use to evaluate how their broker-dealers handle their orders and, in particular, assess how their broker-dealers comply with best execution obligations and manage the potential for information leakage and conflicts of interest.

The Commission does not believe that it is necessary for the achievement of this goal to require, at this time, that the Rule 606(b)(3) order handling report include the additional order

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316 See KCG Letter at 6-7; see also EMSAC Rule 606 Recommendations, supra note 16, at 3. As the KCG Letter acknowledged, however, these FIX recommended best practices focus on institutional execution information and not order routing data. See id. at 7. As such, the Commission does not believe that they would be an appropriate basis for the order handling disclosures that are the focus of the Commission's amendments to Rule 606(b)(3).

handling statistics suggested by commenters. There is a large spectrum of types of customers, and commenters suggested a wide range of order handling statistics. While certain additional data metrics may be more useful to certain types of market participants, the Commission does not view any particular data element suggested by commenters as likely to significantly enhance the degree to which the Rule 606(b)(3) report provides a standardized baseline of order handling information that is broadly useful to all customers that submit orders to their broker-dealers.

Moreover, incorporating additional metrics into the Rule 606(b)(3) report may increase the complexity of the report and the associated costs, and the Commission believes at this time that such costs and complexity would not be justified by the expected benefits to customers in evaluating the order handling performance of their broker-dealers. As summarized above, commenters suggested revised or additional disclosures related to execution quality and fee/rebate information.[317] While incorporating the suggested execution quality and fee/rebate disclosures into the Rule 606(b)(3) reports may add extra utility to the reports for certain customers, in adopting Rule 606(b)(3) the Commission must balance the cost of compliance against the usefulness of the information that is required to be disclosed under the rule. Requiring broker-dealers to make mandatory disclosures imposes a cost on broker-dealers, and each additional required data item potentially raises that compliance cost, as well as potentially increases the complexity of the report. Incorporating commenters' suggested disclosures into the Rule 606(b)(3) reports would, therefore, likely raise compliance costs and add to the complexity of the report. As but one example, requiring the broker-dealer to disclose the displayed quote at

[317] As is also summarized above, some commenters suggested requiring execution venues to provide standard liquidity indicators to broker-dealers. See supra note 315. The rule amendments being adopted today enhance the order handling information that broker-dealers must provide to their customers, and do not address standardization of the information that execution venues provide to broker-dealers. As such, these comments are outside the scope of this rulemaking.

the time when the broker-dealer routed an order to an exchange could increase reporting complexity and costs in calculating the displayed quote and the synchronization of clocks between a broker-dealer and the venue.

In light of the fact that the Commission believes that the Rule 606(b)(3) disclosures are sufficient to provide a baseline, standardized set of information that customers can use to evaluate how their broker-dealers handle their orders, the Commission believes that the compliance costs and added complexity associated with commenters' suggested additional disclosures would not be justified by the marginal utility that these disclosures may add to the report beyond that which is provided by the disclosures. Specifically, the additional metrics related to fees and rebates and economic incentives suggested by commenters could provide customers with additional information on how venue fees and rebates impact how their broker-dealers' handle their orders, particularly in light of the potential for conflicts of interest caused by fees and rebates; however, the Commission believes that the Rule 606(b)(3) disclosures already contain sufficient fee and rebate information for customers to adequately evaluate their broker-dealers' potential conflict of interest. Thus, any added value in the report created by the suggested fee and rebate information would, in the Commission's view, not justify the additional complexity, as well as the additional costs, associated with including the information. Likewise, the additional execution quality metrics suggested by commenters could provide customers with more information regarding how their broker-dealers achieve best execution and attempt to prevent information leakage, but the Commission believes that the Rule 606(b)(3) disclosures, as proposed, already provide a sufficient basis for customers to evaluate their broker-dealers' performance in this regard. Thus, any added value in the report created by the suggested

execution quality disclosures would not, in the Commission's view, be justified by the additional costs and complexity associated with including the information.

The Commission believes that adopting the Rule 606(b)(3) report content as proposed will help minimize the reporting complexity and costs, while creating a report that is universally useful across the spectrum of customer types, some of which may be more sophisticated than others in their ability to digest the reported information. The Commission did not receive comments suggesting that the order handling statistics set forth in Rule 606(b)(3) as proposed would be too difficult or complex for broker-dealers to generate or for institutional customers in particular to use.

This determination is not an indication that the Commission has formed a decision on the validity or usefulness of the various different order handling metrics that commenters suggested. Rather, in light of the fact that, as noted above, the Commission believes that Rule 606(b)(3), as proposed, is reasonably designed to provide a standardized baseline of order handling disclosures that (subject to two de minimis exceptions) all customers that submit not held NMS stock orders to their broker-dealers are entitled to receive, the Commission has determined to adopt Rule 606(b)(3) as proposed.

As stated elsewhere herein, customers remain free to negotiate with their broker-dealers for additional disclosures regarding broker-dealers' handling of their orders, and broker-dealers of course remain free to compete by providing more detailed information than is required under Rule 606(b)(3). As a result of the rules being adopted today, customers that choose to negotiate with their broker-dealers for additional disclosures will be doing so from a more standardized baseline of enhanced order routing disclosures, and in the case of customers that previously did not receive detailed order handling disclosures from their broker-dealers, from a strengthened

and more informed negotiating position. In light of the Commission's belief that the disclosures required by Rule 606(b)(3), as proposed and as adopted, are reasonably designed to provide such a standardized baseline of order handling information for customers to use to assess their broker-dealers' order handling performance, the Commission believes, at this juncture, that the disclosure of additional order handling statistics would be best left to competitive forces in the market and should not be mandated by Commission rule.

Accordingly, the Commission is adopting as proposed the requirement that certain order routing information be disclosed within the proposed venue segmentation in the Rule 606(b)(3) order handling report. Specifically, Rule 606(b)(3) requires that the order handling information specified in subparagraphs (b)(3)(i) through (iv) of the rule be provided for each venue to which the broker-dealer routed orders for the customer.[318] In addition, Rules 606(b)(3)(i) through (iv) specify the same required information on order routing, order execution, orders that provided liquidity, and orders that removed liquidity as was proposed. Further, Rule 606(b) is being amended to define the term "orders providing liquidity" to mean orders that were executed against after resting at a trading center,[319] and the term "orders removing liquidity" to mean orders that executed against resting trading interest at a trading center.[320] The Commission received no comments regarding these defined terms, and is adopting them as proposed.

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318 See Rule 606(b)(3).

319 See Rule 600(b)(54).

320 See Rule 600(b)(55).

7. Rule 606(c) Quarterly Aggregated Public Report of Rule 606(b)(3) Information

a. Proposal

The Commission proposed to require a broker-dealer that receives orders covered by Rule 606(b)(3) to make publicly available[321] a report that aggregates the Rule 606(b)(3) order handling information for all such orders that it receives.[322] As proposed, broker-dealers would be required to make the report publicly available for each calendar quarter, broken down by calendar month, within one month after the end of the quarter.[323] The Commission proposed that this public aggregated order handling report be mandatory for all of the orders subject to Rule 606(b)(3) that a broker-dealer handles within a calendar quarter regardless of whether any of its customers request customer-specific order handling reports pursuant to Rule 606(b)(3).[324]

In addition, similar to the customer-specific order handling reports required under proposed Rule 606(b),[325] the Commission proposed to require that the public aggregated order handling report be made available using an XML schema and associated PDF renderer published on the Commission's website.[326] Further, the Commission proposed to require that broker-dealers keep such public aggregated order handling reports posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website.[327]

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321 "Make publicly available" is defined in Rule 600 of Regulation NMS. See 17 CFR 242.600(b)(36).

322 See proposed Rule 606(c).

323 See id.

324 See id.; see also Proposing Release, supra note 1, at 49459.

325 See supra Section 0.A.0.

326 See proposed Rule 606(c).

327 See id. See Proposing Release, supra note 1, at 49458-59 for additional detail on the Commission's proposal.

b. Final Rule and Response to Comments

The Commission is not adopting proposed Rule 606(c), and thus the Commission is not adopting the proposed requirement that broker-dealers publicly report, on a quarterly basis, aggregated Rule 606(b)(3) order handling information. As a result, under the rule amendments being adopted today, for not held orders in NMS stock, broker-dealers are required only to provide the customer-specific order handling reports required by Rule 606(b)(3) (or Rule 606(b)(1), as applicable),[328] and there is no public reporting component of the information set forth in Rule 606(b)(3).

Multiple commenters stated that directed orders should be excluded from the proposed Rule 606(c) public aggregated reports, or alternatively, that directed orders should be reported separately.[329] Commenters asserted that including a customer's directed orders in the public aggregated report could cause the report to be misleading because routing behavior that was directed by the customer pursuant to a directed order would be misrepresented in the report as routing behavior determined by the broker-dealer itself pursuant to its independent routing logic.[330] One commenter stated that even a directed versus non-directed order distinction in the public report would be insufficient because institutional clients provide instructions on orders without explicitly directing an order to a venue, such as by directing a large portion of their order

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328 See supra Sections 0.A.1.0.0-0.

329 See SIFMA Letter at 2, 5; FIF Letter at 5; Fidelity Letter at 6; STA Letter at 5-6; STA Letter II at 2; EMSAC Rule 606 Recommendations, supra note 16, at 3. One commenter suggested that orders from individuals should be reported separately in the quarterly public reports under proposed Rule 606(c), but that suggestion was premised on the commenter's view that the proposal to define "institutional order" based on dollar amount would result in large orders from retail customers being considered institutional orders. See ICI Letter at 10. Similarly, another commenter stated that the quarterly public reports under proposed Rule 606(c) should exclude retail block-sized orders. See Fidelity Letter at 6. As discussed above, the Commission is adopting Rule 606(b) disclosure requirements based on whether an order is held or not held and is not adopting proposed Rule 606(c). As a result, retail block-sized orders will not be included in quarterly public reports unless these orders are subject to Rule 606(a)(1).

330 See SIFMA Letter at 5; FIF Letter at 5; Fidelity Letter at 6; ICI Letter at 3.

flow to high-rebate venues or directing their brokers to avoid routing to a specific venue or type of venue, and instead the commenter suggested a more nuanced distinction in the report between orders that solely reflect the broker-dealer's routing decisions and orders that are subject to specific client routing instructions.[331] One commenter stated that the proposed Rule 606(c) aggregated order handling report would not serve its intended use and that a modified version should be available only to institutional customers upon request.[332] This commenter expressed concern that the public aggregated report would be easy for market analysts to misinterpret, creating confusion in the market, and that it could present potential competitive concerns for broker-dealers, such as with respect to the confidentiality of their business operations and book of business.[333] Some commenters believed that public disclosure of aggregated order handling information could be useful to market participants.[334]

In light of the comments submitted and after further consideration, the Commission is not adopting Rule 606(c) or any requirement that a broker-dealer make publicly available an aggregated report with respect to its handling of customers' not held NMS stock orders.[335] The Commission believes, upon further consideration, that the proposed quarterly public reports of aggregated Rule 606(b)(3) order handling information would be of limited utility. As discussed in greater detail below, the Commission believes that the proposed reports would not allow for fair "apples-to-apples" comparisons, and instead could generate misleading impressions of

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331 See SIFMA Letter at 5.

332 See Fidelity Letter at 6.

333 See Fidelity Letter at 6 and n.14.

334 See HMA Letter at 4; CFA Letter at 9; Markit Letter at 27; Better Markets Letter at 3-6.

335 The Commission also received comment that provided suggestions and modifications to proposed Rule 606(c), which the Commission is not adopting. See, e.g., Capital Group Letter at 4-5; Fidelity Letter at 6; Citadel Letter at 1; FIF Letter at 13; Markit Letter at 27, 29.

broker-dealer order handling practices. As a result, the aggregated Rule 606(b)(3) information in the proposed public report may not allow for meaningful insight into the quality of broker-dealers' order routing performance or comparisons of order handling performance across broker-dealers, and is unlikely to provide the same benefits as the aggregated Rule 606(a) public disclosures for held orders in NMS stock because of the disparate nature and trading behavior of customers that use not held orders in NMS stock.[336]

As noted above, broker-dealers may have different types of customers that utilize not held orders in NMS stock. For example, one broker-dealer may serve as a broker-dealer for only quantitative trading firms, while another broker-dealer may serve only investment advisers. Each customer has a unique set of circumstances, goals, and order flow that dictates how a broker-dealer handles that customer's orders. For example, the trading objectives of a quantitative firm primarily trading principally are different from the trading objectives of another type of customer, such as a diversified mutual fund. In light of this, the Commission believes that there would be limited ability to understand the quality of broker-dealers' routing performance or meaningfully compare broker-dealer order handling performance based on the aggregated information for not held NMS stock orders in the proposed public reports without requiring additional disclosures regarding customers and potentially sensitive proprietary information.

Indeed, broker-dealers' order routing behavior differs based on the customers they serve, and understanding the quality of their routing performance would likely require an understanding of the investment or trading needs of their underlying customers, which would not be obtainable

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336 For similar reasons, the Commission is not requiring broker-dealers to disclose additional information or a more detailed order handling report as part of regular public reporting as was suggested by some commenters. See, e.g., Better Markets Letter at 3-6.

from the aggregated information in the public reports. Moreover, some customers give complete discretion to a broker-dealer in handling their orders while other customers may place limits on or provide instructions regarding how a broker-dealer can handle their orders. In fact, orders from certain customers frequently limit broker-dealer discretion in some manner. For example, cost-sensitive customers may place restrictions on the venues a broker-dealer may use to execute their orders, which could have a significant impact on how the broker-dealer routes those orders and the resulting execution metrics. In particular, some customers choose cost-plus fee arrangements and specify a desire to maximize rebates or low pricing venues to the extent practicable. Or, customers may instruct broker-dealers to use certain algorithms or strategies that preference certain routing options or behavior. A taking algorithm acts differently than a posting algorithm, and there may also be routing strategies or configurations available with both taking and posting algorithms. Further, the Commission believes based on its experience that quantitative firms, for example, represent a large segment of the institutional marketplace and a significant portion of them use largely passive trading strategies, which can result in a demand for advantageous pricing arrangements, including cost-plus arrangements with their broker-dealers. This, in turn, can result in selecting rebate maximization strategies. Such strategies are often meaningfully different than the posting strategies used by long-only mutual funds, for example. The Commission believes based on its experience that aggregating the order handling information of cost-sensitive customers or customers that have specified certain algorithms or trading strategies for the broker-dealer to utilize with customers that have given the broker-dealer complete routing discretion creates dilutive effects in the aggregated information that wash out the routing nuances that are relevant to each type of customer and important to understanding a broker-dealer's routing decisions when granted full discretion.

The proposed aggregated public disclosures for not held NMS stock orders could therefore be unclear, and potentially misleading, due to the nature or requests of a broker-dealer's specific customers. A report may reflect apparently substandard order handling practices even though the broker-dealer is performing competently or is satisfying specific customer requests. Even a customer interested in comparing the performance of its specific orders to other orders handled by its own broker-dealer would likely be unable to meaningfully analyze the aggregate order handling report because the customer likely would not know the nature of, practices and requests of the broker-dealer's other customers. Due to the limited utility of the public reports as proposed, the Commission further believes that the burden of compiling and publishing aggregate order handling information for not held NMS stock orders does not at this time justify the expected benefits.

In addition, the Commission recognizes that broker-dealers have proprietary methods for order handling, and is cognizant of the sensitive nature of such business practices and intellectual property. The Commission believes that quarterly public disclosures as proposed may risk the exposure of sensitive proprietary information on the broker-dealers' order handling techniques. The Commission noted in the Proposing Release that it believed that any such risk would be minimal, but in combination with the potentially limited utility of the public reports as proposed, the Commission believes it is not appropriate to impose any such risk, no matter how small. In addition, the risk may be more pronounced for certain segments of customers than it is for others. In particular, new or small broker-dealers with only a few customers may end up disclosing confidential order routing information if such information is required to be included in public reports. This could significantly disadvantage new or small broker-dealers.

Furthermore, the Commission believes that not held order handling is not analogous to

held order handling and that the benefits that accrue from the public disclosure of aggregated held order handling reports are not likely to accrue from the public disclosure of aggregated not held order handling reports. Currently, Rule 606(a) requires public aggregated reporting of certain order handling information.[337] As noted in the Proposing Release, some market participants have stated that the public disclosure of meaningful data in Rule 606 reports can assist broker-dealers in evaluating their own performance relative to other firms.[338] The Commission also has previously noted its belief that these public aggregated disclosures spur competition among broker-dealers to provide enhanced order routing services and better execution quality.[339]

The Commission does not believe the same benefits would accrue to customers that utilize not held orders due to the fundamental differences between held order flow and not held order flow. Held orders are typically non-directed orders with no specific order handling instructions for the broker-dealer. Moreover, held order flow generally is handled similarly by broker-dealers — held orders are generally small orders that are internalized or sent to OTC market makers if marketable or fully executed on a single trading center if not marketable.[340] By contrast, not held order flow is diverse and fundamentally different from held order flow in that customers may provide specific order handling instructions to their broker-dealers or limit the order handling discretion of their broker-dealers in some manner. As discussed above, broker-dealers' handling of customer not held orders is impacted by specific customer needs such as

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337 See Rule 606(a).

338 See Proposing Release, supra note 1, at 49461.

339 See id.

340 See Proposing Release, supra note 1, at 49460. Internalization is the process in which a broker-dealer fills an order to buy a security from its own inventory, or fills an order to sell by taking a security into its inventory. See Proposing Release, supra note 1, at 49439 n. 64.

cost sensitivity, the preferencing or disfavoring of specific market venues, or other requests that limit broker-dealer discretion. The disparate behavior of customers when using not held orders limits the ability of both customers and broker-dealers to utilize the aggregated Rule 606(b)(3) order handling information in the public reports to better understand broker-dealers' routing behavior or perform meaningful comparisons of order routing performance across broker-dealers.

B. Public Order Routing Report Under Rule 606(a)

Prior to today, Rule 606(a) required, among other things, that broker-dealers that route customer orders — which do not include orders for NMS stock above $200,000 in market value or orders for options contracts above $50,000 in value[341] — provide a quarterly public report of certain information regarding non-directed orders in NMS securities that is organized by listing market and that sets forth material aspects of their relationships with the ten venues to which they routed the largest number of total non-directed orders and with any venue to which they routed 5% or more of such orders (collectively, "Specified Venues").[342] In the Commission's view, customers have benefited from the Rule 606(a) reporting requirements for customer orders, as the Rule 606(a) reports spurred competition among broker-dealers to provide enhanced order routing services and better execution quality, which in turn motivated trading centers to deliver more efficient and innovative execution services as they competed for order flow.

But as noted above and detailed in the Proposing Release, changes to market structure and order routing practices have led the Commission to analyze the current requirements for

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341 See Rule 600(b)(18).

342 See Rule 606(a).

public order routing disclosure under Rule 606(a).[343] The U.S. equity markets have evolved in recent years to become more automated, dispersed, and complex, and the resulting competition among trading centers has intensified practices to attract order flow, including order flow from retail customers. As a result of this market evolution, the utility of the Rule 606(a) public reports and the degree to which they help achieve the rule's intended benefits may be diminished. It is, therefore, important for the Commission to enhance the Rule 606(a) public order handling reports in a manner designed to update them consistent with market developments.

Accordingly, the Commission believes that it is appropriate to make limited updates to the Rule 606(a) requirements regarding broker-dealers' public disclosure of their order routing practices, and in conjunction with Rule 606(b)(3)'s applicability to NMS stock orders of any size that are submitted on a not held basis, amend Rule 606(a) such that it applies to NMS stock orders of any size that are submitted on a held basis. Commenters were broadly supportive of enhanced Rule 606(a) order routing disclosures.[344] The Commission believes that the amendments being adopted today to Rule 606(a), discussed in detail below, should enhance broker-dealers' public order handling disclosures by bringing them more up-to-date with current market and order routing practices, and by focusing them on the types of NMS stock orders for which the public disclosures are most relevant and would be most useful. As a result, customers — and retail investors in particular — that submit orders to their broker-dealers should be better able to assess the quality of order handling services provided by their broker-dealers and whether their broker-dealers are effectively managing potential conflicts of interest.

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343 See supra Section 0; see also Proposing Release, supra note 1, at 49461.

344 See, e.g., KCG Letter at 1-3; Ameritrade Letter at 3; SIFMA Letter at 1; Better Markets Letter at 1, 8-9; HMA Letter at 3; FSR Letter at 1; Citadel Letter at 1; and CFA Letter at 1.

1. Orders Covered By Rule 606(a) Public Disclosures

a. Proposal

As discussed above,[345] the proposed definition of "institutional order" dovetailed with the current definition of "customer order." This would allow the Commission to maintain Rule 606(a)(1)'s applicability to orders in NMS stocks with a market value less than $200,000 and NMS securities that are options contracts, and propose enhancements to the existing disclosure requirements under Rule 606(a)(1) for such orders, without altering the substance of the current definition of "customer order" in Rule 600(b). However, the Commission proposed to rename the current "customer order" definition as "retail order" without changing the substance of the definition itself, such that an order for NMS stock would be categorized as either an "institutional order" or a "retail order" under Rule 600(b) and for the purposes of Rule 606 depending on its dollar value, and an order for an NMS security that is an option contract for less than $50,000 in market value would be categorized as a "retail order."[346]

b. Final Rule and Response to Comments

As discussed above,[347] the Commission is not adopting a definition of "institutional order" or an order dollar value-based approach to delineate the NMS stock orders covered by new Rule 606(b)(3). Consequently, the Commission is not renaming the term "customer order" as "retail order" in Rule 600(b), and the Commission is amending Rule 606(a)(1) without any order dollar value limitation on the rule's coverage of NMS stock orders.[348] As amended, Rule

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345 See supra Sections 0.A.1.0.

346 See Proposing Release, supra note 1, at 49434, 49465-66 for additional detail on the Commission's proposal.

347 See supra Section 0.A.1.0.

348 Moreover, in light of the fact that the Commission is not adopting the proposed amendment to rename "customer order" as "retail order" in Rule 600(b), and instead is maintaining "customer order" as currently defined, there is no longer any need, as proposed, to revise existing cross-references to "customer order" in

606(a)(1) applies to NMS stock orders of any size that are submitted on a held basis. Rule 606(a)(1) also continues to apply to any order (whether held or not held) for an NMS security that is an option contract with a market value less than $50,000, as the Commission did not propose, and is not adopting, any modifications to Rule 606's coverage of option orders.[349]

Specifically, Rule 606(a)(1), as amended, states that every broker-dealer must make publicly available for each calendar quarter a report on its routing of non-directed orders in NMS stocks that are submitted on a held basis and in non-directed orders that are customer orders in NMS securities that are option contracts during that quarter broker down by calendar month. As noted above,[350] the Commission is adopting a modified definition of the term "non-directed order" that no longer includes a dollar-value limitation on NMS stock orders,[351] but continues to exclude orders from a broker-dealer. Because Rule 606(a)(1) explicitly references "non-directed orders" in NMS stock, the rule no longer covers only NMS stock orders with a market value less than $200,000; rather, the rule now applies to NMS stock orders of any size that are submitted on a held basis. With respect to orders for NMS securities that are option contracts, however, Rule 606(a)(1) explicitly references "non-directed orders" that are "customer orders." By virtue of this reference to "customer orders," Rule 606(a)(1) continues to apply to an order for an NMS security that is an option contract only if the order has a market value less than $50,000. In both cases — held orders for NMS stock and orders for NMS securities that are option contracts — Rule 606(a)(1) applies only if the order is not from a broker-dealer.

Rules 600(b)(19), 600(b)(23), 600(b)(48), 605, 606, and 607. See Proposing Release, supra note 1, at 49466.

349 See supra notes 37 and 135.

350 See supra Section 0.A.1.b.vii.

351 Consistent with the modifications discussed in Section III.A.1.b.vii, supra, Rule 606(a)(1)(i) also is revised to no longer refer to the defined term "customer order."

Rule 606(a)(1)'s application to held NMS stock orders of any size works in unison with the customer-specific disclosures contained in Rule 606(b)(1) and Rule 606(b)(3) to ensure that all NMS stock orders are covered by order handling disclosure rules and to avoid overlap between such rules.[352] If Rule 606(a)(1)'s coverage were not amended in conjunction with Rules 606(b)(1) and (3), there would be overlap between the these rules — e.g., Rule 606(a)(1) would apply to NMS stock orders of less than $200,000 in market value, and Rule 606(b)(3) also would apply to such orders to the extent that they were not held. As discussed above, numerous commenters criticized the proposed order dollar value-based distinction between the orders covered by Rule 606(a)(1) versus Rule 606(b)(3), and the Commission believes that it would be more appropriate to differentiate the NMS stock orders covered by each rule according to whether an order is held or not held.

For the same reasons as discussed above,[353] the Commission believes that this method of differentiation is appropriate because broker-dealers generally handle not held orders differently from held orders due to the discretion they are afforded with not held orders but not with held orders. As a result, the information pertinent to understanding broker-dealers' order handling practices for not held orders is not the same as for held orders. Unlike with not held orders, the Commission's concern regarding how broker-dealers handle held orders is less about the difficulties posed by more automated, dispersed and complex order routing and execution practices. Rather, the Commission's main concern with held NMS stock orders is the impact of intensified competition for customer order flow — particularly retail investor order flow — that has arisen concomitant with the rise in the number of trading centers and the introduction of new

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352 See supra Section 0.A.0.0.

353 See id.

fee models for execution services.[354] Financial inducements to attract order flow from broker-dealers that handle retail investor orders have become more prevalent and for some broker-dealers such inducements may be a significant source of revenue.[355] These financial inducements create new, and in many cases significant, potential conflicts of interest for broker-dealers with respect to how they handle held orders from customers — and retail customers in particular. The Commission believes that enhanced public disclosures should focus on providing more detailed information regarding these financial inducements, as opposed to the different information geared towards not held orders from customers that is set forth in Rule 606(b)(3).

In practice, the coverage of Rule 606(a)(1) as amended is likely to be largely similar to the rule's coverage under its pre-existing application to NMS stock orders of less than $200,000 in market value. The Commission expects that the majority of customer (i.e., non-broker-dealer) NMS stock orders having a market value of at least $200,000 will be not held orders and therefore not be covered under Rule 606(a)(1).[356] Retail investors' orders are typically submitted on a held basis and are typically smaller in size.[357] So the smaller NMS stock orders that were covered by the pre-existing rule likely also were held orders and therefore will be covered by Rule 606(a)(1) as amended. The difference is that, under the rule as amended, any non-broker-dealer NMS stock orders that are for at least $200,000 in value and submitted on a held basis will

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354 See supra Section 0; see also Proposing Release, supra note 1, at 49434.

355 See id.

356 See supra Section 0.A.1.0.0 (citing Eric Kelley and Paul Tetlock, How Wise Are Crowds? Insights from Retail Orders and Stock Returns, 68 Journal of Finance 1229-1265 (2013) and Brad M. Barber and Terrence Odean, Trading Is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors, 55 Journal of Finance 773 (2000)).

357 Accordingly, the Commission believes that the number of higher value held orders for NMS stock that will be included in the Rule 606(a)(1) public reporting regime will be limited.

now be covered by Rule 606(a)(1) and thus subject to public aggregated required order routing disclosures for the first time.

Under the Proposal, a non-broker-dealer NMS stock order with a market value of at least $200,000 would have been defined as an institutional order — regardless of whether it was a held or not held order — and subject to the new customer-specific disclosures set forth in proposed Rule 606(b)(3) and the new public aggregated order handling report set forth in proposed Rule 606(c). The adopted approach to NMS stock order handling disclosure is based on whether an NMS stock order is submitted on a held or not held basis. In addition to being appropriate for non-broker-dealer NMS stock held orders with a market value of less than $200,000, the Commission believes that the Rule 606(a)(1) public disclosures are appropriate for non-broker-dealer NMS stock held orders with a market value of $200,000 or more because, regardless of the order's dollar value or the nature of the customer that submitted the order, broker-dealers must attempt to execute held orders immediately. Thus, the Commission's concerns noted above for held NMS stock orders are implicated regardless of the order's dollar value or the nature of the customer that submitted the order. The Rule 606(a)(1) public disclosures are designed to address these concerns in particular by focusing on providing enhanced transparency for financial inducements faced by broker-dealers when determining where to route held NMS stock order flow. Moreover, to the extent that it is a retail customer that submits a larger held NMS stock order for $200,000 or more, commenters appeared to agree that such orders would be appropriately covered by Rule 606(a)(1).[358] The Commission believes that this enhancement over the current reporting regime will benefit customers that submit held

[358] See, e.g., Fidelity Letter at 2-3; Wells Fargo Letter at 5; KCG Letter at 4; Thomson Reuters Letter at 1; FSR Letter at 3-4; Citadel Letter at 2-3; Ameritrade Letter at 2.

NMS stock orders, including large-sized ones. They will be better able to assess the nature and quality of the order handling services being provided by their broker-dealers, including the potential for broker-dealer conflicts of interest. They will also benefit to the extent that broker-dealers are spurred to compete further by providing enhanced order routing services and better execution quality, which in turn could motivate trading centers to deliver more efficient and innovative execution services as they compete for order flow.

2. Marketable Limit Orders and Non-Marketable Limit Orders

a. Proposal

The Commission proposed to amend Rule 606(a)(1)(i) and (ii) to require the public order routing report to split limit orders and separately disclose them as marketable and non-marketable.[359] In connection with this new requirement, the Commission also proposed to amend Rule 600(b) of Regulation NMS to include a definition of the term "non-marketable limit order," which the Commission proposed to define to mean any limit order other than a marketable limit order.[360]

b. Final Rule and Response to Comments

The Commission is adopting as proposed the amendments to Rule 606(a)(1)(i) and (ii) to require the disclosure of order routing information for marketable limit orders separately from non-marketable limit orders.[361] The Commission also is adopting as proposed the definition of the term "non-marketable limit order" to mean any limit order other than a marketable limit

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[359] See Proposing Release, supra note 1, at 49462.

[360] See proposed Rule 600(b)(51). See Proposing Release, supra note 1, at 49462 for additional detail on the Commission's proposal.

[361] See Rule 606(a)(1)(i)-(ii). As noted above, the Commission also has revised Rule 606(a)(1)(i) to remove the reference to the term "customer order." See supra note 351.

order.[362] While one commenter believed that the separation is unlikely to be valuable to retail customers and that the separation will not promote additional competition amongst broker-dealers,[363] most commenters who addressed this issue supported distinguishing between non-marketable and marketable limit orders in the Rule 606(a) disclosures and believed that this separation would provide customers with valuable and more useful information.[364]

As noted in the Proposing Release,[365] historically, trading centers have offered payment for order flow or other financial inducements to broker-dealers based upon whether their order flow is marketable or non-marketable. As a result, whether an order is marketable or non-marketable will often determine where the broker-dealer routes the order. Certain broker-dealers route a large portion of marketable investor orders to OTC market makers with whom they have payment for order flow or other arrangements.[366] Non-marketable investor orders, on the other hand, are more frequently routed to exchanges with a "maker-taker" fee schedule, to capture a rebate when the non-marketable order is executed.[367]

In light of the different incentives broker-dealers encounter when handling marketable limit orders versus non-marketable limit orders, and the resulting differences in how and where broker-dealers route marketable limit orders versus non-marketable limit orders, the Commission believes that requiring that the Rule 606(a) reports disclose order routing information separately for marketable limit orders and non-marketable limit orders will significantly enhance their

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362 See Rule 600(b)(50).

363 See FIF Letter at 9.

364 See, e.g., EMSAC Rule 606 Recommendations, supra note 16, at 3; CFA Letter at 4-5, 9; Fidelity Letter at 8-9; Ameritrade Letter at 3.

365 See Proposing Release, supra note 1, at 49440.

366 See id.

367 See id.

utility. The Commission continues to believe that classifying limit orders into marketable and non-marketable categories will provide greater transparency into broker-dealers' different routing practices for these two categories of limit orders, which will allow customers and other market participants to more fully assess broker-dealers' routing decisions for each type of order and the potential impact on execution quality, including whether broker-dealers are effectively managing their potential conflicts of interest. Providing greater public transparency as to broker-dealers' distinct routing practices for marketable limit orders and non-marketable limit orders also may increase competition among broker-dealers and minimize the potential conflicts of interest between maximizing revenue and the duty of best execution.[368]

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[368] See Transaction Fee Pilot Proposing Release, supra note 2, at 13310; see also Robert Battalio, Shane A. Corwin, and Robert Jennings, Can Brokers Have it All? On the Relation between Make-Take Fees and Limit Order Execution Quality, 71 Journal of Finance 2193, 2195 (2016) ("Battalio, Corwin, and Jennings Paper") (finding that fill rates for displayed limit orders are lower on exchanges with higher take fees).

3. Payment for Order Flow Disclosures – Rules 606(a)(1)(iii) and (iv)

a. Proposal

The Commission proposed to amend Rule 606(a)(1) to require more detailed disclosures regarding a broker-dealer's relationships with the venues to which it routes orders.[369] Specifically, the Commission proposed to amend Rule 606(a)(1) to include in a new Rule 606(a)(1)(iii) a requirement that, for each Specified Venue, the broker-dealer must report the net aggregate amount of any payment for order flow received, payment from any profit-sharing relationship received, transaction fees paid, and transaction rebates received, both as a total dollar amount and on a per share basis, for each of the following non-directed order types: (1) market orders; (2) marketable limit orders; (3) non-marketable limit orders; and (4) other orders.[370]

The Commission also proposed to amend the existing payment for order flow disclosures and re-locate them to new Rule 606(a)(1)(iv), which would require that the discussion of the material aspects of the broker-dealer's relationship with a Specified Venue include any terms, written or oral, of payment for order flow arrangements or profit-sharing relationships that may influence a broker-dealer's order routing decision including among other things: (1) incentives for equaling or exceeding an agreed upon order flow volume threshold, such as additional payments or a higher rate of payment; (2) disincentives for failing to meet an agreed upon minimum order flow threshold, such as lower payments or the requirement to pay a fee; (3)

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369 See Proposing Release, supra note 1, at 49463.

370 See proposed Rule 606(a)(1)(iii).

volume-based tiered payment schedules; and (4) agreements regarding the minimum amount of order flow that the broker-dealer would send to a venue.[371]

b. Final Rule and Response to Comments

i. Rule 606(a)(1)(iii)

The Commission is adopting Rule 606(a)(1)(iii) as proposed, and therefore is requiring that, for each Specified Venue, the broker-dealer report the net aggregate amount of any payment for order flow received, payment from any profit-sharing relationship received, transaction fees paid, and transaction rebates received, both as a total dollar amount and on a per share basis, for each of the following non-directed order types: (1) market orders; (2) marketable limit orders; (3) non-marketable limit orders; and (4) other orders.[372] Since these requirements are part of Rule 606(a)(1), they apply to a non-directed NMS stock order of any size that is submitted on a held basis as well as a non-directed order (whether held or not held) for an NMS security that is an option contract with a market value less than $50,000.[373] The Commission continues to believe that identifying specific information regarding payments or rebates received by the broker-dealer and fees paid by the broker-dealer for each category of order type by Specified Venue will provide customers and investors broadly with useful information to more completely evaluate the order handling services provided by broker-dealers. Specifically, the Commission continues to believe that disclosure of the information required by Rule 606(a)(1)(iii) will allow customers to better understand a broker-dealer's management of conflicts of interest when routing orders to a particular Specified Venue.

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371 See proposed Rule 606(a)(1)(iv). See Proposing Release, supra note 1, at 49462-63 for additional detail on the Commission's proposal.

372 See Rule 606(a)(1)(iii).

373 See Rule 606(a)(1); see also supra Section 0.0.0.0.

One commenter supported requiring the disclosure of the net aggregate amount of any payment for order flow or rebates received from or transaction fees paid to each venue based on order type on a dollar amount and per share basis.[374] Two other commenters stated that an aggregate measure would not be meaningful and would vary based on the amount of order flow handled by the broker.[375] One of these commenters suggested that a combination of average payment for order flow with a description of the terms of any payment for order flow and any profit sharing arrangements would be more meaningful,[376] and the other commenter argued that a more meaningful disclosure is the amount of payment received on a per share/contract basis.[377]

The Commission agrees with commenters that the disclosure of payment for order flow on a per share basis will provide meaningful information to customers regarding the importance of a specific venue to their broker-dealer. The disclosure of the aggregate amount of payment for order flow to a broker-dealer from a specific venue will give customers an even greater understanding of the overall importance of a specific venue to their broker-dealer. The additional cost to a broker of providing this payment for order flow information in aggregate form, if that broker-dealer is already providing this information on a per share basis, will be minimal. The Commission believes that an aggregate measure of a broker-dealer's financial arrangements with Specified Venues will provide additional information to investors and customers regarding the incentives and disincentives underpinning a broker-dealer's routing strategy for customer orders. In turn, this should help give investors and customers a more

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374 See CFA Letter at 9.

375 See Schwab Letter at 2; Ameritrade Letter at 3-4. One of these commenters noted that the Commission previously considered and rejected imposing a requirement for brokers to disclose the aggregate amount of payment for order flow from each venue. See Ameritrade Letter at 3-4 (citing Rule 606 Predecessor Adopting Release, supra note 7, at 75427).

376 See Schwab Letter at 2.

377 See Ameritrade Letter at 3-4.

complete understanding and comprehensive view of the potential conflicts of interest faced by a broker-dealer when routing orders and how the broker-dealer manages those conflicts. The aggregate measure will, by its nature, vary with the amount of the order flow handled by the broker-dealer, but the Commission does not believe that this renders the measure meaningless. To the contrary, an aggregate measure will provide customers and investors with transparency beyond that available prior to these amendments regarding the volume of orders that a broker-dealer handles subject to payment for order flow, profit sharing, or other arrangements. This could be useful information to investors and customers trying to assess what size or type of broker-dealer would best suit their investment needs and goals.

Moreover, the Commission adopted Predecessor Rule 606 primarily to address the serious problems that can arise from market fragmentation.[378] As noted above,[379] since Predecessor Rule 606 was adopted in 2000, the equity markets have become significantly more fragmented, dispersed, and complex, particularly in light of the onset of electronic, automated trading. In addition, financial inducements to attract order flow from broker-dealers that handle retail investor orders have become more prevalent and for some broker-dealers such inducements may be a significant source of revenue.[380] The Commission understands that most broker-dealers that handle a significant amount of retail investor orders receive payment for order flow in connection with the routing of such orders or are affiliated with an OTC market maker that executes the orders.[381] Thus, while one commenter pointed out that the Commission declined to require an aggregate measure of a broker-dealer's payment for order flow in Predecessor Rule

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378 See Rule 606 Predecessor Adopting Release, supra note 7, at 75415.

379 See supra Section 0; see also Proposing Release, supra note 1, at 49436.

380 See Proposing Release, supra note 1, at 49441.

381 See id.

606(a)(1),[382] the Commission believes that the market landscape has changed significantly since the adoption of Predecessor Rule 606 such that an aggregate measure is now warranted. With increased market fragmentation and pervasive payment for order flow and other financial arrangements between broker-dealers and execution venues, the Commission believes that its prior concerns expressed in the Rule 606 Predecessor Adopting Release about requiring an aggregate measure — namely, potential difficulty, subjectivity and costliness in generating the measure due to variance in payment for order flow arrangements, and a potentially inaccurate portrayal of the relative financial incentives created by payment for order flow arrangements versus profit sharing arrangements[383] — today are outweighed by the need to provide investors and customers with a more complete understanding of the degree to which broker-dealers are bound to such arrangements.

Additional commenters suggested other changes or limitations to proposed Rule 606(a)(1)(iii).[384] Specifically, one commenter suggested removing fee and payment information from Rule 606(a)(1)(iii) and instead providing it in a narrative section of the report, which would include the net fees paid and net payments received in cents per share for each execution destination.[385] One commenter suggested a more "general disclosure" that is more easily digestible around net payment for order flow, as the commenter did not believe that the proposed disclosures would contribute favorably to transparency for retail customers due to the voluminous amounts of information that they would produce according to the commenter.[386]

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382 See supra note 375.

383 See Rule 606 Predecessor Adopting Release, supra note 7, at 75427.

384 See, e.g., FIF Letter at 3, 5 and 11; FIF Addendum at 5; STA Letter at 3; Markit Letter at 31.

385 See FIF Letter at 3, 5 and 11; FIF Addendum at 5.

386 See STA Letter at 3. This commenter also suggested a twelve month period of time to review the new rule and determine whether or not there are sufficient benefits, as measured by the levels of retail inquiries,

Another commenter suggested that payment for order flow be characterized as "negotiated volume tiers," "standard volume tiers," and "value based" to represent arrangements that are negotiated with the venue that reflect the perceived value of the order flow to that venue.[387]

As noted above, prior to today's rule amendments, Rule 606(a)(1) required a broker-dealer to provide a discussion of the material aspects of its relationship with a Specified Venue, including a description of any arrangement for payment for order flow or any profit-sharing relationship. The Commission believes that the disclosures set forth in Rule 606(a)(1)(iii) as adopted are reasonably designed to provide an additional level of quantification and detail regarding a broker-dealer's relationship with Specified Venues that would help customers better assess the degree to which a broker-dealer faces conflicts of interests in connection with its customer order routing decisions, and how the broker-dealer manages those conflicts of interest. At the same time, the Commission does not believe that the information required by Rule 606(a)(1)(iii) would be overly complicated or burdensome for customers — and retail customers in particular — to consume. For example, Rule 606(a)(1) currently requires, in general, disclosure of any amounts per share or per order that the broker-dealer receives pursuant to any payment for order flow arrangement, any transaction rebates, and the extent to which the broker-dealer would share in profits derived from the execution of non-directed orders under any profit sharing relationship with a Specified Venue.

While some commenters suggested that the rule require different methods of quantification or that the broker-dealer disclose different metrics related to its financial

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compared to costs of maintaining the reporting regime. See id. Order flow payment information will be contained in quarterly public reports under Rule 606(a)(1)(iii) and not produced based on customer inquiry.

387 See Markit Letter at 31.

arrangements with Specific Venues, at this juncture, the Commission believes that the required disclosures set forth in Rule 606(a)(1)(iii) are reasonably designed to provide a significant enhancement in the usefulness of the information that customers receive from broker-dealers' with respect to order routing, and should help provide customers with a more complete understanding of the conflicts of interest faced by broker-dealers and how those conflicts are managed.

ii. Rule 606(a)(1)(iv)

The Commission also is adopting Rule 606(a)(1)(iv) as proposed, and therefore is requiring that the broker-dealer report the material aspects of its relationship with each Specified Venue, including a description of any arrangement for payment for order flow and any profit-sharing relationship and a description of any terms of such arrangements, written or oral, that may influence a broker's or dealer's routing decision including, among other things, incentives for meeting or disincentives for not meeting an agreed upon order flow threshold, volume-based tiered payment schedules, and minimum order flow agreements.[388] The Commission has acknowledged that payment for order flow arrangements are intensively fact-based in nature and may vary across broker-dealers.[389] At the same time, in light of market structure changes since the Rule 606 Predecessor Adopting Release, among other things, the Commission continues to believe that disclosure of any terms, written or oral, that may influence a broker-dealer's order routing decision would be useful for customers to assess the potential conflicts of interest facing broker-dealers when implementing their order routing decisions and would provide more

388 See Rule 606(a)(1)(iv).

389 See Proposing Release, supra note 1, at 49464.

complete information for customers to better understand and evaluate a broker-dealer's order routing decision.[390]

The Commission is requiring that a broker-dealer disclose any incentives that a Specified Venue provides to the broker-dealer for equaling or exceeding a volume threshold by offering additional payments or a higher rate of payment, or conversely, any disincentives that a Specified Venue provides to the broker-dealer for failing to meet an agreed upon minimum order flow threshold, such as a lower payment or charging a fee.[391] The Commission understands that such arrangements may vary among venues, as well as for each broker-dealer sending orders to those venues, and some venues provide higher rebates for meeting or exceeding order flow quotas or charge financial penalties for failing to meet order flow quotas.[392] The Commission believes that such incentives and disincentives influence a broker-dealer's decision to either meet or route additional order flow to exceed the threshold, and should be disclosed to inform customers of their broker-dealer's potential conflicts of interest. The broker-dealer must describe any such incentives or disincentives in its report, such as (but not limited to) any payment amounts or rates that are based on target order volume flow thresholds, as these are terms of the broker-dealer's relationship with the Specified Venue that may influence its routing decision; it is not sufficient for the broker-dealer just to disclose the fact that an incentive or disincentive exists.

Further, the Commission is requiring broker-dealers to disclose any volume-based tiered payment schedules with a Specified Venue.[393] Venues that offer these payment schedules typically offer incrementally higher rebates or lower fees to broker-dealers for additional order

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390 See id. at 49463-64.

391 See Rule 606(a)(1)(iv)(A) through (B).

392 See Proposing Release, supra note 1, at 49463-64.

393 See Rule 606(a)(1)(iv)(C).

flow volume.[394] The Commission believes that these payment schedules can encourage a broker-dealer to route additional order flow to such venue in an effort to reap a financial benefit and should be disclosed.

Additionally, the Commission is requiring broker-dealers to disclose agreements regarding the minimum amount of order flow that a broker-dealer would be required to send to a Specified Venue.[395] These types of agreements typically specify that a broker-dealer must send a minimum number of orders or shares to a venue during a particular time period.[396] The Commission believes that such disclosures would help customers evaluate whether their broker-dealers face conflicts of interest when determining where to route their orders.

Finally, the Commission acknowledges that as market structure evolves, new types of arrangements not specifically listed may arise. The four arrangements referenced in Rule 606(a)(1)(iv) are not an exhaustive list of terms of payment for order flow arrangements or profit-sharing relationships that may influence a broker-dealer's order routing decision that are required to be disclosed. Rule 606(a)(1)(iv) requires a discussion of the material aspects of the broker-dealer's relationship with each Specified Venue, including a description of any terms of such payment for order flow or profit-sharing arrangements that may influence a broker-dealer's order routing decision for the orders covered by Rule 606(a)(1),[397] which orders, as discussed

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394 See Proposing Release, supra note 1, at 49463-64.

395 See Rule 606(a)(1)(iv)(D).

396 See Proposing Release, supra note 1, at 49463-64.

397 For example, if a broker-dealer receives a discount on executions in other securities or some other advantage for directing order flow in a specific security to a Specified Venue, or if a broker-dealer receives equity rights in a Specified Venue in exchange for directing order flow there, then all terms of that arrangement must be disclosed including any securities covered by the arrangement with any and all terms of the arrangement specific to each security. If a broker-dealer receives variable payments or discounts based on order types and the amount of such orders sent to a Specified Venue, e.g., marketable orders, non-marketable orders, or auction orders, then all terms of that arrangement must be disclosed. In addition, because such arrangements would influence a broker-dealer's order routing decision, the amended rule

above, include any non-directed NMS stock order of any size that is submitted on a held basis as well as any non-directed order (whether held or not held) for an NMS security that is an option contract with a market value less than $50,000.[398]

As described above, because certain terms of payment for order flow arrangements or profit-sharing relationships may encourage broker-dealers to direct their orders to a specific venue in order to achieve an economic benefit or avoid an economic loss, potential conflicts of interest may arise. The Commission believes that disclosure of such information will be useful for customers to assess the extent to which a broker-dealer's payment for order flow arrangements and profit-sharing relationships may potentially affect or distort the way in which their orders are routed. The Commission further believes that providing customers a comprehensive description of such quantifiable terms of a broker-dealer's relationship with a Specified Venue will allow them to fully appreciate the nature and extent of potential conflicts of interest facing their broker-dealers and assist them in evaluating the broker-dealers' management of such potential conflicts of interest.

Some commenters supported the disclosure of any agreement that may influence a broker-dealer's routing decisions, including oral agreements or arrangements.[399] One commenter explicitly supported the disclosure of payment for order-flow and profit-sharing arrangements between broker-dealers and specified venues, including whether or not the broker-dealer passes on any of the rebates or order-flow payments to the same customers whose orders generated such

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requires disclosure of the details of any arrangement between a broker-dealer and a Specified Venue where the level of execution quality is negotiated for an increase or decrease in payment for order flow.

398 See Rule 606(a)(1); see also supra Section 0.0.0.0.

399 See, e.g., HMA Letter at 11; Markit Letter at 31.

payments.[400] One commenter suggested further requiring broker-dealers to describe in more meaningful terms any payment for order flow arrangements and profit-sharing relationships with certain venues that may influence their order routing decisions.[401] This commenter supported the proposed enhanced disclosures but expressed concern that they only require broker-dealers to provide a discussion of the material aspects of their relationship with the top venues to which they route.[402] One commenter, however, believed that the proposed description of terms for payment for order flow arrangements would result in the disclosure of a large and unnecessary amount of information.[403] Another commenter believed that enhanced disclosures may result more in confusion than clarity and that the information contained in the current disclosures is generally adequate.[404]

Rule 606(a)(1) requires a discussion of the material aspects of a broker-dealer's relationship with a Specified Venue regarding payment for order-flow or profit-sharing. The expansion contained in new Rule 606(a)(1)(iv) is intended to capture all such arrangements with Specified Venues as all such arrangements – whether written or oral – may be relevant to the customer. The Commission acknowledges that some commenters supported additional disclosure in Rule 606(a)(1)(iv), while two commenters – representing the brokers who will be providing this information as opposed to retail customers themselves – believed that Rule 606(a)(i)(iv), as proposed, would disclose too much information to retail customers. The

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400 See Better Markets Letter at 4-6.

401 See CFA Letter at 9.

402 See CFA Letter at 5.

403 See Fidelity Letter at 9. The commenter requested clarity regarding whether this requirement means that broker-dealers must duplicate exchange's rule filings containing volume tiered pricing. See id. The Commission does not believe that such filings must be "duplicated" in an order routing report. However, the terms of payments from an exchange must be included in the discussion of the arrangement of terms with the Specified Venue.

404 See FIF Letter at 11.

Commission believes that Rule 606(a)(1)(iv) strikes an appropriate balance by, on one hand, providing customers with disclosures that will better enable them to assess their broker-dealers' payment for order flow arrangements and profit-sharing relationships, and the potential for resulting conflicts of interest, while on the other hand providing information that will not be overly voluminous or difficult to comprehend. The Commission believes the information contained in the reports should be straightforward to customers familiar with the operation of the markets, and will thus generally conform to EMSAC's recommendations regarding clarity and comprehension of the reports. To the extent a customer does not understand these disclosures, the Commission expects that the customer would ask its broker-dealer for greater explanation of the arrangement.

4. Format of Public Order Routing Report

a. Proposal

The Commission proposed to require that the publicly available quarterly order routing report required by Rule 606(a)(1) be made available using an XML schema and associated PDF renderer published on the Commission's website.[405] The Commission also proposed to amend Rule 606(a)(1) to require every broker-dealer to keep the Rule 606(a)(1) reports posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website.[406] These proposed requirements were based on considerations similar to those supporting the parallel format and website retention proposals for order routing reports under proposed Rule 606(c).[407]

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405 See proposed Rule 606(a)(1).

406 See id.

407 See Proposing Release, supra note 1, at 49465-66 for additional detail on the Commission's proposal.

b. Final Rule and Response to Comments

i. XML/PDF Format

The Commission is adopting as proposed the requirement that the public order handling reports required under Rule 606(a)(1) be made available using an XML schema and associated PDF renderer published on the Commission's website. Of the comments received on the proposed reporting format, most supported a machine-readable or standardized format[408] or XML in particular.[409] The use of XML has been adopted in a number of recent Commission rulemakings[410] and the Proposal to use an XML format here was supported by most commenters.[411] The Commission believes that it is appropriate, and would be useful to the broadest segment of market participants, to adopt the requirement that the customer-specific and publicly available quarterly customer order routing reports be made available using an XML schema to be published on the Commission's website.

The Commission continues to believe that providing the Rule 606(a)(1) quarterly public reports in the proposed format will promote consistency and comparability of the reports. In contrast to commenters' views noted above, the Commission believes that providing these reports in the commonly used PDF/XML format will create benefits of consistency and comparability of the reports for customers that justify the costs. Accordingly, the Commission believes that it is appropriate to adopt the amendment to Rule 606(a)(1) to require that the

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408 See, e.g., HMA Letter at 12; Markit Letter at 17.

409 See, e.g., Capital Group Letter at 4; Better Markets Letter at 2; CFA Letter at 11; FIA Letter at 2.

410 See, e.g., Securities Exchange Act Release Nos. 79095, 81 FR 81870 (November 18, 2016) (adopting Investment Company Reporting Modernization); 74246, 80 FR 14437 (March 19, 2015) (adopting Security-Based Swap Data Repository Registration, Duties, and Core Principles); 72982 (September 4, 2014), 79 FR 57183 (September 24, 2014) (adopting Asset-Backed Securities Disclosure and Registration).

411 See, e.g., Capital Group Letter at 4; Better Markets Letter at 2; FIF Letter at 17; CFA Letter at 11; FIA Letter at 2. For a detailed discussion of comments relating to the XML format, see supra Section 0.0.0.0.0.

quarterly public order routing report be made available using an XML schema and associated PDF renderer published on the Commission's website.[412]

ii. Retention of Rule 606(a)(1) Reports

The Commission is adopting as proposed the amendment to Rule 606(a)(1) to require every broker-dealer to keep the reports required by Rule 606(a)(1) posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website.[413] The Commission received comments addressing the proposed retention period of three years,[414] with one commenter supporting it,[415] and other commenters calling for different retention periods.[416] The Commission believes that it is appropriate to require that the publicly available quarterly order routing reports under Rule 606(a)(1) be maintained for a period of three years from the date of initial posting in light of the consistency of this requirement with the requirement under Rule 17a-4(b) that broker-dealers preserve certain documents for a period of not less than three years.[417] While one commenter noted that Rule 17a-4(b) only requires that the documents be preserved in an "easily accessible place" for the first two years,[418] the Commission believes that due to the public nature of the reports, the utility and purpose of the reports, and the low burden of maintaining data on a website for an additional year, the reports

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412 As discussed above, several commenters suggested alternatives to the general use of an XML schema and associated PDF renderer for the report, and other commenters called generally for the inclusion of standardized headers for the report. See supra Section 0.A.5.c. The Commission is adopting the proposed use of the XML schema and associated PDF renderer without header information for the same reasons detailed above.

413 See Rule 606(a)(1).

414 See Citadel Letter at 1; FIF Letter at 13; Markit Letter at 29.

415 See Citadel Letter at 1.

416 See FIF Letter at 13; Markit Letter at 29.

417 See 17 CFR 242.17a-4(b).

418 See FIF Letter at 13.

should be retained on a public website for the full three years as proposed. Accordingly, the Commission is adopting as proposed the requirement that the Rule 606(a)(1) publicly available quarterly order handling report be kept posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website.

In a related issue, in question 116 of the Proposing Release, the Commission asked whether it should require broker-dealers to make publicly available the prior three years' worth of quarterly reports from the effective date of the rule.[419] One commenter opposed this suggestion, commenting that it would be an extremely large undertaking, and noting that circumstances may have changed over the last two to three years that would make comparison of the data difficult and possibly misleading.[420] The Commission believes that it should not adopt a requirement to make publicly available the prior three years' worth of publicly available quarterly order routing reports from the effective date of the rule, as this requirement may be too burdensome and result in data that is not easily comparable across broker-dealers. Nevertheless, while broker-dealers are not required by rule to post on their website past Rule 606(a)(1) reports that were created prior to the amended rule's effectiveness, the Commission believes that making historical Rule 606(a) data available to customers and the public could be useful to customers or market participants seeking to analyze past routing behavior of broker-dealers. As such, the Commission notes that broker-dealers are neither prevented nor discouraged from voluntarily and publicly disclosing such historical data. The Commission believes that some broker-dealers may engage in such voluntary disclosure in an effort to compete more effectively for order flow by providing even greater transparency than what is required under the rule.

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419 See Proposing Release, supra note 1, at 49466.

420 See FIF Letter at 13.

The Commission also received comments addressing whether broker-dealers should be required to make the reports available on their own websites or on a centralized website.[421] Three commenters supported centralizing reporting, specifically recommending that either FINRA or the Commission host the data.[422] One commenter stated that it did not necessarily think that the Commission or FINRA should be forced to cover the expense of maintaining a centralized website as long as the data can be found publicly.[423]

One of the chief goals of the rule amendments being adopted today is to enable customers to more readily and meaningfully assess broker-dealers' order handling practices. The Commission acknowledges that locating each broker-dealer's Rule 606(a)(1) report in a centralized repository could help facilitate that goal. At the same time, there are potentially significant cost and time delays associated with developing a centralized repository and the related mechanisms for allowing individual broker-dealers to upload and manage their reports in a safe and secure manner. The Commission believes that the obstacles associated with developing a centralized repository pose a greater risk of hindering customers' ability to assess broker-dealer order routing performance than is posed by the necessity of accessing each broker-dealer's Rule 606(a) report on the particular broker-dealer's website in the absence of a centralized repository. Accordingly, the Commission is not adopting an additional requirement that the Rule 606(a) quarterly public order handling reports be maintained in a centralized public repository.

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421 See Proposing Release, supra note 1, at 49461, 49466; HMA Letter at 4; FIA Letter at 1; FIF Letter at 13; CFA Letter at 11; HMA II Letter at 4, 7-8.

422 See HMA Letter at 4, 7-8; FIF Letter at 13; CFA Letter at 11.

423 See Markit Letter at 29.

5. Division of Rule 606(a) Report's Section on NMS Stocks by S&P 500 Index and Other NMS Stocks

a. Proposal

The Commission proposed to amend Rule 606(a)(1) to remove the requirement that Rule 606(a)(1) reports be divided into three separate sections for securities listed on the NYSE, securities that are qualified for inclusion in NASDAQ, and securities listed on the American Stock Exchange or any other national securities exchange.[424] By proposing to remove this requirement, the Commission intended to require broker-dealers to disclose the required order routing information for NMS stocks as a group rather than divided by listing market.

b. Final Rule and Response to Comments

The Commission is adopting as proposed the amendment to remove the requirement that Rule 606(a)(1) reports be divided into three separate sections for securities listed on the NYSE, securities that are qualified for inclusion in NASDAQ, and securities listed on the American Stock Exchange or any other national securities exchange. The Commission notes that the language is stale, as NASDAQ is now registered as a national securities exchange and the American Stock Exchange is now known as NYSE American LLC.[425] Further, the Commission continues to believe that separating the Rule 606(a) order routing reports by primary listing

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424 See proposed Rule 606(a)(1). See Proposing Release, supra note 1, at 49465 for additional detail on the Commission's proposal.

425 See Rule 606 Predecessor Adopting Release, supra note 7. In October 2008, the American Stock Exchange LLC was renamed "NYSE Alternext US LLC." See Securities Exchange Act Release No. 58673 (September 29, 2008), 73 FR 57707 (October 3, 2008) (SR-Amex-2008-62). In March 2009, NYSE Alternext US LLC was renamed "NYSE Amex LLC." See Securities Exchange Act Release No. 59575 (March 13, 2009), 74 FR 11803 (March 19, 2009) (SR-NYSEALTR-2009-24). In May 2012, NYSE Amex LLC was renamed "NYSE MKT LLC." See Securities Exchange Act Release No. 67037 (May 21, 2012), 77 FR 31415 (May 25, 2012) (SR-NYSEAmex-2012-32). In March 2017, NYSE MKT LLC was renamed "NYSE American LLC." See Securities Exchange Act Release No. 80283 (March 21, 2017), 82 FR 15244 (March 27, 2017) (SR-NYSEMKT-2017-14).

market is not particularly useful to customers for the reasons noted in the Proposal.[426] When the Commission adopted what became Rule 606 (then Rule 11Ac1-6) in 2000, the primary listing markets looked and operated very differently than they do today. For example, NYSE and the American Stock Exchange were primarily manual markets with limited electronic trading, while NASDAQ was a quote-driven dealer market and not yet a national securities exchange. Today, with the adoption of Regulation NMS and considerable advancements in computerized trading technology, the trading landscape is highly automated, dominated by electronic trading, and more widely dispersed across different trading venues. As a result, the primary listing markets no longer factor as prominently as they once did in the execution of the securities that they list. In addition, the commenters who addressed the issue supported the removal of the division of the Rule 606(a) reports by listing market.[427] Accordingly, the Commission believes that the division of the Rule 606(a) reports by listing market is no longer warranted or appropriate, as such division is no longer particularly useful to customers interested in analyzing their broker-dealers' routing practices.[428]

The Commission requested comment in the Proposing Release regarding whether the Rule 606(a) public order routing reports should instead be categorized according to whether a particular security is included in the Standards & Poor's 500 ("S&P 500") index.[429] Multiple commenters believed that categorization by S&P 500 index would be useful,[430] while one

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426 For example, from February 2005 to February 2014, NYSE's market share in its listed securities declined from 78.9% to 20.1%. See Memorandum from the SEC Division of Trading and Markets to the SEC Market Structure Advisory Committee (April 30, 2015), available at http://www.sec.gov/spotlight/emsac/memo-rule-611-regulation-nms.pdf.

427 See Markit Letter at 32; Fidelity Letter at 9; FIF Letter at 12.

428 See FIF Letter at 3.

429 See Proposing Release, supra note 1, at 49466.

430 See Markit Letter at 32; Fidelity Letter at 9; Schwab Letter at 3.

commenter believed that segmenting by S&P 500 stocks and other stocks may be too complex.[431] One commenter stated that subscription to the S&P 500 index would present a cost to broker-dealers and the commenter would only recommend such S&P 500 index categorization if broker-dealers would not incur an additional cost.[432] In addition, the EMSAC recommended, among other things, that Rule 606 reports be divided by securities included in the S&P 500 Index and other NMS stocks.[433]

While the Commission believes that the handling of NMS stocks no longer varies materially based on their primary listing market, the Commission believes that the handling of NMS stocks may vary based on their market capitalization value and trading volume. Thus, customers that place held orders in NMS stock could benefit from a delineation based on S&P 500 index in the Rule 606(a)(1) report. Inclusion in the S&P 500 is based on a variety of factors that may be of utility to customers when reviewing their disclosures, including that S&P 500 constituents must be U.S. companies and must meet market capitalization, public float, financial viability, liquidity, and price requirements.[434] As a result, the Commission is requiring that the Rule 606(a)(1) report be categorized by whether the security is included S&P 500 index as of the first day of the quarter or is another NMS stock.[435] The Commission also notes that the list of securities included in the S&P 500 index is readily available on the internet on many free websites, and thus there should be minimal cost to broker-dealers to remain abreast of the

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431 See FIF Letter at 12.

432 See Markit Letter at 32.

433 See EMSAC Rule 606 Recommendations, supra note 16.

434 See S&P 500 Fact Sheet, available at https://us.spindices.com/indices/equity/sp-500.

435 See Rule 606(a)(1). The Commission understands that securities may move in and out of the S&P 500 during a quarter, but that such movement is not common. The Commission further believes requiring the reporting based on the composition as of the first day of the quarter will be easily administrable and will allow broker-dealers to know what securities they will need to track throughout the quarter for inclusion in this reporting category.

composition of the index.[436] The Commission further notes that many data dissemination services obtain this information from the S&P and redistribute this information as part of data packages consumed by broker-dealers as a part of the broker-dealers normal course of business.[437] Thus, the Commission believes that there will be few or no additional data costs to broker-dealers resulting from this requirement. The Commission believes that this amendment would help further modernize the Rule 606(a)(1) report and provide customers that place held NMS stock orders – and retail investors in particular – with more relevant information about how their orders are routed.

6. Calendar Month Breakdown

a. Proposal

The Commission proposed to amend Rule 606(a)(1) to require that the public order routing reports required by the rule be broken down by calendar month.[438] Rule 606(a)(1) currently requires that broker-dealers make order routing reports publicly available for each calendar quarter, and that such reports contain aggregate quarterly information on order routing.

b. Final Rule and Response to Comments

The Commission is adopting as proposed the amendment to Rule 606(a)(1) to require that the publicly available quarterly order routing reports be broken down by calendar month.[439]

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436 The Commission further notes that changes to the composition of the S&P 500 are publicly announced. See, e.g., Press Release, S&P Dow Jones Indices, Huntington Ingalls Industries Set to Join S&P 500; Scientific Games to Join S&P MidCap 400 and Ultra Clean Holdings to Join S&P SmallCap 600 (December 28, 2017), available at https://us.spindices.com/documents/index-news-and-announcements/20171228-spdji-bard-huntington-games-ultra-press-release.pdf.

437 The Commission understands that broker-dealers have access to the constituent list for the S&P 500 through data feeds available from widely used data dissemination services, such as Bloomberg, Thomson Reuters, and Morningstar. The Commission understands that most broker-dealers already pay for data feeds that contain this composition information.

438 See proposed Rule 606(a)(1). See Proposing Release, supra note 1, at 49465 for additional detail on the Commission's proposal.

439 See Rule 606(a)(1).

Several commenters supported the proposed break-down by calendar month or proposed requiring that the reports be made available on a monthly basis.[440] Another commenter believed that a quarterly breakdown is adequate, and that monthly reports would not add value but rather could confuse investors.[441]

The Commission believes that disclosing the information contained in the Rule 606(a)(1) reports by calendar month will allow customers to better assess whether their broker-dealers' routing decisions are affected by changes in fee structures and the extent such changes affect execution quality. In particular, a calendar-month breakdown will provide customers and market participants generally with greater insight into any month-to-month changes in routing behavior by broker-dealers in response to monthly changes in trading center fee structures.[442] As indicated by the support expressed by commenters for a calendar-month breakdown, the Commission believes that such insight could be valuable to customers attempting to assess the quality of broker-dealer order routing services and the extent to which broker-dealers engage in rebate-seeking or fee-avoiding behavior when routing customer orders. The Commission does not believe that presenting the information as a monthly breakdown would be more confusing than the current presentation of the information in the aggregate for the entire quarter covered by the report.

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440 See, e.g., Markit Letter at 29; Fidelity Letter at 9.

441 See FIF Letter at 13.

442 The Commission understands that trading centers generally bill in monthly increments and modify their fee structures to reflect such monthly billing. See Proposing Release, supra note 1 at 49465, and see, e.g., Securities Exchange Act Release No. 83025 (April 10, 2018), 83 FR 16410 (April 16, 2018) (SR-NASDAQ-2018-25).

7. Execution Metrics

As discussed above, the Commission is adopting targeted, limited enhancements to the public order routing disclosures required under Rules 606(a)(1) that are designed to shed additional light on broker-dealers' routing practices and the extent to which broker-dealers encounter and manage potential conflicts of interest stemming from payment-for-order flow arrangements, profit-sharing relationships, trading venue fees and rebates, or other factors. As the Commission previously noted, commenters were broadly supportive of these enhanced order routing disclosures.[443] However, the EMSAC and several commenters suggested further enhancements to these disclosures – many specifically to include more or different execution quality statistics.[444]

As noted above, the Commission purposely did not propose significant enhancements or modifications to the Rule 606(a) public reports and did not include enhanced requirements regarding execution statistics. Rather, the Commission proposed targeted, limited enhancements in Rule 606(a) that focus on financial inducements connected to broker-dealers' order routing. The Commission believes that these enhancements are appropriately designed to enable customers – and retail customers in particular – to better assess their broker-dealers' order routing performance and, in particular, potential conflicts of interest that their broker-dealers face when routing their orders and how their broker-dealers manage those potential conflicts.

Accordingly, the Commission continues to believe that the limited modifications to Rule 606(a) as proposed are reasonably designed to further the goal of enhancing transparency

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443 See, e.g., KCG Letter at 1-3; STA Letter I at 2-4; Ameritrade Letter at 3; Better Markets Letter at 1, 8-9; HMA Letter at 2-4; FSR Letter at 1; Citadel Letter at 1; CFA Letter at 1.

444 See EMSAC Rule 606 Recommendations, supra note 16, at 3Markit Letter at 8-10, 25, 30; Fidelity Letter at 6-; Better Markets Letter at 3-8; Angel Letter at 3-7CFA Letter at 10; Schwab Letter at 2; HMA Letter at 7, 10-12; Ameritrade Letter at 3.

regarding broker-dealers' order routing practices and customers' ability to assess the quality of those practices. The Commission does not believe that it is necessary for the achievement of this goal to require, at this time, that the Rule 606(a) public order handling reports include the additional, specific execution quality statistics suggested by some commenters. The additional disclosures suggested by the commenters would raise compliance costs and add to the complexity of the report. In adopting the amendments to the report, the Commission is seeking a balance between updating the current reports to provide useful additional information to customers and the cost of compliance by broker-dealers. The Commission believes that the required disclosures, including the new disclosures adopted today, contain sufficient information for customers to make an informed decision to evaluate their broker-dealers' order routing performance. In order to reach this balance between cost and benefit, the Commission is not adopting the additional disclosures recommended by commenters at this time.

The Commission notes, as stated above, that this determination is not an indication that the Commission has formed a decision on the validity or usefulness of the various different execution quality statistics that commenters suggested. Rather, in light of the Commission's belief that Rule 606(a), as proposed, provides an appropriate level of insight into the widespread financial arrangements between broker-dealers and execution venues that may affect broker-dealers' order routing decisions, the Commission believes that it is an appropriate and a balanced approach at this juncture to adopt Rule 606(a) as proposed. The Commission believes that adopting the Rule 606(a) report content as proposed will help minimize the reporting complexity and costs, and help create a report that is more universally useful across the spectrum of customers.

C. Amendment to Disclosure of Order Execution Information

The Commission proposed to amend Rule 605(a)(2) to require market centers to keep reports required pursuant to Rule 605(a)(1) posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website.[445] One commenter supported the Proposal,[446] while another commenter suggested a two-year time period and further suggested that comparing what it characterized as "out-of-date" information may lead to misleading analysis due to circumstances changing over time.[447]

The Commission is adopting, without any change, the proposed amendment to Rule 605(a)(2) to require market centers to keep reports required pursuant to Rule 605(a)(1) posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website.[448] While one commenter suggested a two-year posting period instead of a three-year period, the three-year period is consistent with the identical posting requirement for the Rule 606(a)(1) reports that the Commission is adopting today and, for the same reasons as expressed with regard to the Rule 606(a) report, the Commission believes that the three-year posting requirement is appropriate. In particular, the Commission notes, again, that a three-year retention period is consistent with the requirement under Rule 17a-4(b) that broker-dealers preserve certain documents for a period of not less than three years.[449] Furthermore, while all historical reports would be "out-of-date" information, the Commission believes that the reports will be useful and not lead to misleading analyses because the Commission expects customers and the public to use the historical information to compare

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445 See Proposing Release, supra note 1, at 49466.

446 See Citadel Letter.

447 See FIF Letter.

448 See Rule 605(a)(2).

449 See 17 CFR 242.17a-4(b)

information from the same time period. The public information also will provide a historical record of a market center's order execution information. As also noted above, even though market centers are not required by rule to post on their website past Rule 605(a) reports that were created prior to the amended rule's effectiveness, the Commission believes that making historical data available to customers and the public could be useful to customers or market participants seeking to analyze such data, and market centers are neither prevented nor discouraged from voluntarily and publicly disclosing such historical data.

IV. Paperwork Reduction Act

Certain provisions that the Commission is adopting today contain "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[450] The Commission published a notice requesting comment on the collection of information requirements in the Proposing Release[451] and submitted relevant information to the Office of Management and Budget for review in accordance with the PRA.[452] The current collection of information for Rule 606 entitled "Disclosure of order routing information" is being modified in a way that creates new collection of information burden estimates and modifies existing collection of information burden estimates. The existing collection of information for Rule 605 entitled "Disclosure of order execution information" is being modified in a manner that does not alter the collection of information burden estimate. Compliance with these collections of information requirements is mandatory. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the agency displays a currently valid control number.

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450 44 U.S.C. 3501 et seq.

451 See Proposing Release, supra note 1, at 49477.

452 44 U.S.C. 3507; 5 CFR 1320.11.

The hours and costs associated with complying with the rule amendments being adopted today constitute reporting and cost burdens imposed by the collection of information for Rule 606. As described in more detail below, certain estimates have been modified, as necessary, to conform to the adopted amendments and to reflect the most recent data available to the Commission.

The Commission requested comment on the collection of information requirements in the Proposing Release. As noted above, the Commission received comment on the Proposing Release. Views of commenters relevant to the Commission's analysis of burdens, costs, and benefits of the rule amendments being adopted today are discussed below.

A. Summary of Collection of Information

The amendments to Rule 606, as adopted, contain "collection of information requirements" within the meaning of the PRA for broker-dealers that receive and handle certain orders in NMS stocks. As detailed in Section III, supra, in adopting the amendments, the Commission has made certain changes to the amendments as originally proposed.

1. Customer-Specific Disclosures Under Rule 606(b)(3)

Rule 606(b)(3) of Regulation NMS, as adopted, requires a broker-dealer, on request of a customer that places with the broker-dealer, directly or indirectly, NMS stock orders of any size that are submitted on a not held basis (subject to two de minimis exceptions) to electronically disclose to such customer within seven business days of receiving the request, a report on the broker-dealer's handling of such orders for that customer for the prior six months, broken down by calendar month. The report would contain certain information on the customer's order flow with the reporting broker-dealer as well as certain columns of information on orders handled by

the broker-dealer, as described below, categorized by venue and separated by directed and non-directed orders.[453]

2. Amendment to Current Public and Customer-Specific Disclosures

Rule 606(a) of Regulation NMS, as amended: (1) breaks down the existing limit order disclosures into separate categories of marketable limit orders and non-marketable limit orders;[454] (2) requires certain disclosures for each Specified Venue;[455] (3) requires certain disclosures by broker-dealers relating to terms of payment for order flow arrangements and profit-sharing relationships;[456] (4) requires that such reports be broken down by calendar month;[457] (5) requires that such reports be kept posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website;[458] and (6) replaces the requirement that the Rule 606(a)(1) report be divided into three separate categories by listing market with a requirement that the report be divided into two categories: securities included in the S&P 500 Index as of the first day of the quarter; and other NMS stocks.[459] These disclosures are available for non-directed orders in NMS stocks submitted on a held basis having any market value. For orders in NMS securities that are option contracts, these disclosures are available whether the order is submitted on a held or not held basis, but only for customer orders, i.e., orders having a market value of less than $50,000.[460]

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453 See supra Sections 0.A.0.0.0, 0.A.0.0.0.

454 See supra Section 0.0.0.

455 See supra Section 0.0.0.

456 See id.

457 See supra Section 0.0.0.

458 See supra Section 0.0.0.

459 See supra Section 0.0.0.

460 See supra Section 0.0.0.

Rule 606(b)(1), as amended, does not modify any of the current customer-specific disclosure requirements but only requires those disclosures for certain categories of orders. Broker-dealers must now provide the information only for: (i) orders in NMS stocks that are submitted on a held basis; (ii) orders in NMS stocks that are submitted on a not held basis and are exempt from the disclosure requirements of Rule 606(b)(3); or (iii) orders in NMS securities that are option contracts.

The amendments would require reports produced pursuant to Rules 606(a) and 606(b)(1) to be formatted in the most recent versions of the XML schema and the associated PDF renderer as published on the Commission's website.

3. Amendment to Current Disclosures under Rule 605

Rule 605(a)(2), as amended, requires market centers to keep reports required pursuant to the Rule 605(a)(1) posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website.

B. Use of Information

The order handling disclosures required under the adopted amendments to Rule 606 will provide more detailed information to customers that will enable them to evaluate how their orders were handled by their broker-dealers, assess potential conflicts of interest facing their broker-dealers in providing order handling services, and have the ability to engage in informed discussions with their broker-dealers about the broker-dealer's order handling practices. The adopted order handling disclosures can inform future decisions on whether to retain a broker-dealer's services or engage the services of a new broker-dealer. In addition, broker-dealers may use the public disclosures to compete on the basis of order routing services, and academics and others may use the public disclosures pursuant to Rules 605 and 606 to review and analyze broker-dealer routing practices and trading center order executions.

1. Customer-Specific Disclosures Under Rule 606(b)(3)

Rule 606(b)(3), as adopted, provides detailed order routing and execution information to a customer regarding its specific NMS stock orders of any size that are submitted on a not held basis (subject to two de minimis exceptions) during the reporting period. Generally, the five groups of information contained in the order handling report will enable customers to understand where and how their not held NMS stock orders were routed or exposed, as well as where their orders were executed during the reporting period. Customers may use the information contained in the order handling report to assess any considerations a broker-dealer may have faced when routing its not held NMS stock orders to various venues and whether those considerations may have affected how a broker-dealer handled its orders, as well as to assess whether a broker-dealer's order routing practices may have led to risks of information leakage.[461]

The requirement that broker-dealers produce one report for directed orders and one report for non-directed orders will provide a customer with a more precise reflection of how and where its broker-dealer is routing the customer's not held NMS stock orders pursuant to the discretion it is afforded.[462] As noted above, customers may use the order handling disclosures to inform future decisions on whether to retain a broker-dealer's services or engage the services of a new broker-dealer.

2. Amendment to Current Public and Customer-Specific Disclosures

Rule 606(a), as amended, requires broker-dealers to break down the limit order disclosure in the public order routing reports into separate categories of marketable limit orders and non-

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461 See Proposing Release, supra note 1, at 49468.

462 See supra Section 0.A.0.0.

marketable limit orders.[463] The adopted requirement of Rule 606(a) that a broker-dealer disclose the net aggregate amount of any payment for order flow received, payment from any profit-sharing relationship received, transaction fees paid, and transaction rebates received, both as a total dollar amount an on a per share basis, for specified non-directed order types for each Specified Venue, may allow customers to determine how broker-dealers route different types of orders relative to any economic benefit or consequence to the broker-dealer. The requirement in adopted Rule 606(a)(1) that the quarterly reports be broken down by calendar month may allow customers to determine whether and how their broker-dealers' routing decisions changed in response to changing fee and rebate structures in the marketplace, which often change at the beginning of a calendar month. The adopted requirement that such reports be kept posted on a website for three years may allow customers and others, such as researchers, to analyze historical routing behavior of particular broker-dealers. The adopted requirement that broker-dealers categorize the quarterly public Rule 606(a)(1) disclosure by securities included in the S&P 500 Index and other NMS stocks should provide customers and the public with more detailed information on securities that have more similar liquidity and trading characteristics, and should provide a clearer way for customers to review order routing information for securities included in the S&P 500 Index, which attract significant trading interest.[464] In addition, the adopted requirement for broker-dealers to describe any terms of payment for order flow arrangements and profit-sharing relationships with a Specified Venue that may influence their order routing decisions, including information relating to specific incentives or volume minimums, may allow

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463 The Commission discussed the general use of this collection in the Proposing Release. See Proposing Release, supra note 1, at 49468-69.

464 See supra Section 0.0.0.

customers to understand how their broker-dealers route their orders and whether and how such routing is influenced by payment for order flow and/or a profit-sharing relationship.

As noted above, the amendments to Rule 606(b)(1) do not create new data collection obligations but require the disclosures for certain categories of orders.

3. Amendment to Current Disclosures under Rule 605

The adopted requirement that reports required under Rule 605 be kept posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website may allow customers and others to analyze historical order execution quality at various market centers, such as researchers that could provide analysis to better inform investors. The three years of data may be useful to those seeking to analyze how execution quality has changed over time, in addition to changes in response to regulatory or other developments.

C. Respondents

The respondents to the amendments being adopted today are broker-dealers that handle held orders and not held orders received from customers and market centers that create reports pursuant to Rule 605.

1. Initial Estimate

In the proposing release the Commission estimated, as of December 2015, that there were approximately 4,156 total registered broker-dealers. Of these, the Commission estimated that 266 were broker-dealers that route retail orders. The Commission estimated that 200 broker-dealers were involved in the practice of routing institutional orders, all of whom also routed retail

orders. The Commission estimated that there were 380 market centers to which Rule 605 applies.[465]

2. Estimate for Adopted Rule [Amendments to 605 and 606]

The Commission estimates that of the approximately 4,024 total registered broker-dealers,[466] 292 are broker-dealers that handle orders in NMS stocks on a held basis that would be subject to the public disclosure requirements of Rule 606(a) or the current customer-specific disclosure requirements of Rule 606(b)(1).[467] The Commission estimates that 200 broker-dealers would be subject to the new customer-specific disclosure requirements of Rule 606(b)(3) and not meet the requirements for a firm-level de minimis exception under Rule 606(b)(4), i.e., broker-dealers that are involved in the practice of routing NMS stock orders of any size that are submitted on a not held basis, where such order flow constitutes greater than 5% of their total NMS stock order flow.[468] The Commission estimates that there are 381 market centers to which Rule 605 applies.[469]

D. Total Initial and Annual Reporting and Recordkeeping Burdens

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465 See Proposing Release, supra note 1, at 49469.

466 The Commission is basing its estimate on data compiled from responses to Form BD.

467 The Commission estimates that both clearing and introducing brokers handle such orders.

468 For the purposes of estimating burden under the PRA, the Commission believes that all broker-dealers that handle or route orders in NMS stocks will have a mix of customers that are and are not subject to the customer-level de minimis exception described in Rule 606(b)(5). See supra Section 0.A.0.0.0. Accordingly, the Commission estimates that all 200 broker-dealers that handle orders subject to the customer-specific disclosures required by Rule 606(b)(3) and all 292 broker-dealers that route orders subject to the public disclosures required by Rule 606(a) and the existing customer-specific disclosures required by Rule 606(b)(1) will have to modify their systems to comply with those respective rules. If a broker-dealer handles orders subject to the new customer-specific disclosure requirements of Rule 606(b)(3) but qualifies for both de minimis exceptions required by Rules 606(b)(4) and (b)(5), then it is not a respondent to the collection of information required by Rule 606(b)(3) but would still be counted among the respondents to the collection of information required by Rule 606(b)(1).

469 The Commission derived this estimate based on the following: 214 OTC market makers (not including market makers claiming an exemption from the reporting requirements of the Rule), plus 21 exchanges, 1 securities association, 104 exchange market makers, and 41 ATSs.

1. Customer-Specific Disclosures Under Rule 606(b)(3)

a. Initial Reporting and Recordkeeping Burden

i. Baseline Burden

Of the 200 broker-dealers involved in routing orders subject to the customer-specific disclosures described in Rule 606(b)(3), the Commission initially estimated that 25 broker-dealers that handle orders do not currently have systems that obtain all of the information required by the proposed amendments.[470] The Commission estimated that these 25 broker-dealers would be able to perform the required enhancements in-house, but could also use a third-party service provider.[471] Based on discussions with industry sources, the Commission preliminarily estimated that the average one-time, initial burden for broker-dealers that handle orders subject to the customer-specific disclosures described in Rule 606(b)(3) that do not currently create and retain the proposed order handling information to program systems in-house to implement the requirements of the proposed Rule would be 200 hours and $60,420 per broker-dealer.[472] The Commission preliminarily estimated the average one-time, initial burden for broker-dealers that handle orders subject to the customer-specific disclosures described in Rule 606(b)(3) that do not currently create and retain the proposed order handling information to engage a third-party to program the broker-dealers' systems to implement the requirements of the proposed amendments to be 50 hours[473] and $35,000.[474] The Commission preliminarily estimated that of the 25 broker-dealers that handle orders subject to the customer-specific

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470 This estimate was based on discussions with various industry participants. See Proposing Release, supra note 1, at 49470.

471 See id.

472 See id. The Commission derived its preliminary monetized burden estimates based on per hour labor figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013.

473 The monetized hourly burden was estimated at $15,125 per broker-dealer. See id.

474 See id.

disclosures described in Rule 606(b)(3) that do not currently have systems in place to capture the information required by the rule, 10 such broker-dealers would perform the necessary programming upgrades in-house, and 15 would engage a third-party to perform the programming upgrades. Additionally, of the 25 broker-dealers that handle orders subject to the customer-specific disclosures described in Rule 606(b)(3) that do not currently have systems in place to capture the information required by the proposed rule, the Commission estimated that 10 such broker-dealers would need to purchase hardware and software upgrades to fulfill the requirements of the proposed rule at an average cost of $15,000 per broker-dealer, and that the remaining 15 broker-dealers have adequate hardware and software to capture the information proposed by the rule. Therefore, the total initial burden for broker-dealers that handle orders subject to the customer-specific disclosures required by Rule 606(b)(3) that do not currently capture order handling information required by the proposed rule to program their systems to produce a report to comply with the proposed rule change was estimated as 2,750 hours[475] and $675,000.[476]

The Commission preliminarily estimated the average burden for a broker-dealer that already captures information required by the proposed rule to format its systems to produce a report to comply with the proposed rule would be 40 hours.[477] The Commission estimated that 125 broker-dealers would format systems to produce the reports in-house. A broker-dealer that handles such orders that uses a third-party service provider to produce reports using such order handling information would need to need to work with the vendor to ensure the proper data is

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475 The total monetized hourly burden was estimated at $831,075. See id.

476 ($35,000 per broker-dealer that will engage a third-party x 15 such broker-dealers) + ($15,000 per broker-dealer that will need to purchase hardware and software upgrades x 10 such broker-dealers) = $675,000. See id.

477 The monetized hourly burden was estimated at $12,084 per broker-dealer. See id.

captured in the reports. The Commission estimated 50 broker-dealers that handle such orders would use a third-party vendor to ensure data required by the rule is captured in the reports. The Commission estimated the average burden for a broker-dealer that uses a third-party service provider to work with such service provider to ensure proper reports are produced would be 20 hours[478] and $5,000.[479] The Commission preliminarily believed that broker-dealers whose systems currently capture and retain information required by the rule would not need to purchase hardware or software upgrades. Thus, the total burden for broker-dealers that currently obtain the required data but need to format their systems, or work with their data provider, to prepare a report to comply with the proposed rule was estimated as 6,000 hours[480] and $250,000.[481] Therefore, the estimated total initial burden for all broker-dealers to comply with Rule 606(b)(3) was estimated at 8,750 hours[482] and $925,000.[483]

ii. Burden of Adopted Rule

The Commission is revising its initial burden and cost estimates associated with producing the customer-specific reports on order handling required by Rule 606(b)(3)[484] in response to comments received. One commenter criticizes the Commission's estimate of costs involved in producing the data for the reports, which it characterizes as "8 hours," and provides

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478 The monetized hourly burden was estimated at $5,726 per broker-dealer. See id.

479 See id.

480 The total monetized hourly burden was estimated at $1,796,800. See id.

481 $5,000 per broker-dealer that works with a third-party vendor to ensure proper reports are produced x 50 such broker-dealers = $250,000. See id.

482 The total initial monetized hourly burden was estimated at $2,627,875. See Proposing Release, supra note 1, at 49471.

483 See id.

484 Rule 606(b)(3), as proposed, applied to broker-dealers that handle "institutional orders," as defined in the Proposing Release. Rule 606(b)(3), as adopted, applies to NMS stock orders of any size that are submitted on a not held basis (subject to the two de minimis exceptions).

its own estimate of 240 hours per broker-dealer to produce the data for the reports. The commenter does not make clear whether this comment addresses the new customer-specific order handling disclosures required by Rule 606(b)(3) or the amendments to the public order routing disclosures required by Rule 606(a)(1). The commenter also states that "[i]n order to produce the data for the public reports, brokers will all have to modify their OMS system or have their OMS vendor make changes" (emphasis added).[485]

To the extent these comments are addressed to the initial hourly burden for broker-dealers to produce the customer-specific order handling disclosures required by Rule 606(b)(3),[486] the Commission understands them to raise two areas of criticism: the hourly burden estimate for producing the data for the reports and the monetized value of that burden. With respect to the hourly burden, the Commission estimated 200 hours — not 8 hours — for a broker-dealer that handles orders subject to the customer-specific disclosures required by Rule 606(b)(3) to update its systems in-house to capture the information and format the reports required by the rule.[487] However, upon consideration of the comments, and in particular the statements that the implementation would require "at least [] four weeks of developer time,"[488] and result in a "total cost of 240 hours per broker,"[489] the Commission is revising its initial hourly burden estimate for a broker-dealer that handles orders subject to the customer-specific disclosures required by Rule 606(b)(3) to both update its data capture systems in-house and

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485 See Markit Letter at 33.

486 To the extent that these comments are addressed to the burden for the amended disclosures described by Rule 606(a)(1), the Commission addresses them below. See infra Section 0.0.0.0.0.

487 See Proposing Release, supra note 1, at 49470.

488 See Markit Letter at 33. The Commission is revising its initial estimate of 100 Sr. Programmer hours to 160 Sr. Programmer hours = 40-hour work week x 4 ("four weeks of developer time").

489 See id.

format the report required by the rule to 260 hours.[490] The Commission continues to estimate that the initial burden for broker-dealers that handle orders subject to the customer-specific disclosures required by Rule 606(b)(3) to engage a third-party to implement the requirements of the rule to be 50 hours[491] and $35,000.[492]

The commenter also implicitly criticizes the Commission's estimate that only 25 of the 200 total broker-dealers that handle orders subject to the customer-specific disclosures required by Rule 606(b)(3) would need to update their data capture systems by stating that "brokers will all have to modify their OMS system or have their OMS vendor make changes" (emphasis added).[493] Upon consideration of this comment, the Commission is revising its previous estimate that there are some broker-dealers that already capture order handling information required by the rule[494] and instead estimating that all 200 broker-dealers that handle orders subject to the

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490 The Commission estimates the monetized burden for this requirement to be $84,100. (Sr. Programmer for 160 hours at $324 per hour) + (Sr. Database Administrator for 40 hours at $334 per hour) + (Sr. Business Analyst for 40 hours at $269 per hour) + (Attorney for 20 hours at $407 per hour) = 260 hours and $84,100. The Commission derived this estimate based on per hour figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013 adjusted for inflation based on Bureau of Labor Statistics data on CPI-U between January 2013 and December 2017 (a factor of 1.0705). For example, the 2017 inflation-adjusted effective hourly wage rate for attorneys is estimated at $407 ($380 × 1.0705).

491 See supra note 473. The Commission is updating the monetized hourly burden estimate to $16,200 to reflect the latest available labor earnings data. (Sr. Business Analyst for 15 hours at $269 per hour) + (Compliance Manager for 20 hours at $303 per hour) + (Attorney for 15 hours at $407 per hour) = 50 hours and $16,200. The Commission derived this estimate based on per hour figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013 adjusted to December 2017 values. See supra note 490.

492 See Proposing Release, supra note 1, at 49470.

493 See Markit Letter at 33.

494 The Commission preliminarily believed that many broker-dealers that handle orders subject to the customer-specific disclosures described in proposed Rule 606(b)(3) already create and retain the order handling information required by Rule 606(b)(3). Accordingly, the Commission provided two burden estimates, one for broker-dealers that handle orders whose systems do not currently support creating and retaining the information required by Rule 606(b)(3) that would upgrade their systems either in-house or via a third-party service provider, and another for broker-dealers that handle orders whose systems currently do create and retain such information, including those that use a third-party service provider whose systems currently obtain such information. See Proposing Release, supra note 1, at 49469-70.

customer-specific disclosures required by Rule 606(b)(3) will need to update their systems to capture the information required by the rule.

The Commission continues to believe that some broker-dealers will implement the changes in-house, while others will engage a third party vendor, which is supported by the commenter's statement that broker-dealers will have to "modify their OMS system or have their OMS vendor make changes."[495] The Commission believes that it is reasonable to estimate that one third of the 200 broker-dealers that handle orders subject to the customer-specific disclosures required by Rule 606(b)(3) — 67 broker-dealers — will implement the changes in-house, while the remaining number — 133 broker-dealers — will engage a third-party vendor to do so.[496] The Commission continues to estimate that the broker-dealers that will implement the changes in-house will also need to purchase hardware and software upgrades at a cost of $15,000 to fulfill the requirements of the rule.[497]

The Commission is estimating the total initial burden for broker-dealers that will program their systems in-house to capture the data and produce a report to comply with the rule as 17,420 hours[498] and $1,005,000.[499] The Commission is estimating the total initial burden for broker-

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495 See id.

496 The Commission's initial estimate in the Proposing Release of 65 broker-dealers that would implement these changes in-house and 135 broker that would engage a third-party vendor was intended to reflect a ratio of one-third and two-thirds of the total 200 broker-dealers with reporting obligations under Rule 606(b)(3).

497 See Proposing Release, supra note 1, at 49470.

498 17,420 hours = 260 hours x 67 broker-dealers that handle such orders and would perform the necessary programming upgrades in-house. The monetized hourly burden is $5,634,700 = $84,100 x 67 such broker-dealers. See supra note 490.

499 $15,000 per broker-dealer that will need to purchase hardware and software upgrades x 67 such broker-dealers) = $1,005,000. See supra note 496.

dealers that will engage a third-party vendor to program their systems to capture the data and produce a report to comply with the rule as 6,650 hours[500] and $4,655,000.[501]

The commenter states that the Commission did not include an estimate for "monitoring systems for ensuring that strategy definitions are reasonably defined."[502] While the Commission estimated an annual, ongoing burden for a broker-dealer to maintain the assignment of its order routing strategies,[503] the Commission is not adopting the proposed requirement to segment order handling information by order routing strategy.[504]

The commenter also suggests that the Commission's estimate for producing the order handling disclosures "does not include the complexities of the IOI reporting."[505] The Commission considered all the proposed data elements for the order handling disclosure, including those related to actionable IOIs, in estimating the initial burden of complying with the rule. The Commission also considered that, as discussed in Section III.A.2, an actionable IOI is the functional equivalent of an order or quotation, and that actionable IOIs do not include conditional orders in estimating the burden of complying with the rule. Moreover, as noted above, because actionable IOIs convey similar information as an order, the Commission believed, and continues to believe, that including actionable IOIs in the order routing reports would not add much complexity to the reporting practices. The commenter does not address

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500 6,650 hours = 50 hours x 133 broker-dealers that handle such orders and would engage a third-party vendor to perform the necessary programming upgrades. The monetized hourly burden is $2,154,600 = $16,200 x 133 such broker-dealers. See supra note 491.

501 $35,000 per broker-dealer that will need to engage a third-party vendor x 133 such broker-dealers) = $4,655,000. See supra note 492.

502 See Markit Letter at 34.

503 See Proposing Release, supra note 1, at 49473-74.

504 See supra Section 0.A.0.0.0.

505 See Markit Letter at 34.

how the inclusion of actionable IOIs in Rule 606(b)(3) would affect the calculation of the cost. Specifically, as noted above, the Commission is adopting a modification to Rule 606(b)(3) that requires broker-dealers to disclose the fact that actionable IOIs were sent to customers but not the identity of such customers. Compared to proposed Rule 606(b)(3), Rule 606(b)(3) as adopted could reduce the potential initial paperwork burden for broker-dealers, because they do not have to disclose the identity of customers receiving actionable IOIs. The Commission's revised estimate includes and fully reflects consideration of all modifications from the proposed rule text to Rule 606(b)(3) as adopted.

The revised initial burden estimate takes into account the requirement that the disclosures apply to NMS stock orders of any size that are submitted on a not held basis (subject to two de minimis exceptions) instead of to "institutional orders" as defined by a dollar-value threshold in the Proposing Release.[506] A broker-dealer would have to program its systems to filter their order data by a condition — either a dollar -value threshold or a held/not-held indicator (subject to the two de minimis exceptions) — and the work of filtering data by a condition generally is expected to carry the same burden, independent of the filtering condition.

The Commission also believes that this initial hourly burden estimate remains unchanged by the adoption today of a requirement that the customer-specific order handling disclosures described by Rule 606(b)(3) be segmented by directed and non-directed orders.[507] The Commission believes that the systems of all 200 broker-dealers involved in the practice of routing orders subject to the customer-specific disclosures required by Rule 606(b)(3) already capture data related to whether an order is directed or not directed, so this requirement imposes

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506 See supra Section 0.A.1.

507 See supra Section 0.A.0.0.

no additional burden associated with data capture. With respect to formatting the report, the Commission believes that the work of segmenting data by a condition generally carries the same burden, independent of the segmenting condition. Since the burden of segmenting the data by order routing strategy, a requirement which is being eliminated, is similar to the burden of the new requirement to segment the data by directed and non-directed orders, the net burden remains unchanged. Accordingly, the adoption of this requirement does not change the initial hourly burden estimate for capturing the required data or formatting the reports.

Further, this initial hourly burden estimate is unchanged by the Commission's decision today not to adopt proposed requirements to categorize order routing information by order routing strategy,[508] since the burden of categorizing and capturing that information was separately estimated in the Proposing Release.[509]

Therefore, the total initial burden for all 200 broker-dealers that handle orders subject to the customer-specific order handling disclosures required by Rule 606(b)(3) to implement a system that captures the data required by the rule and format that data into a report is estimated to be 24,070 hours and $5,660,000.[510]

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508 See supra Section 0.A.0.0.0.

509 See Proposing Release, supra note 1, at 49467-68.

510 See supra notes 498 and 500 (17,420 hours + 6,650 hours = 24,070 hours). The total estimated initial monetized hourly burden is $7,789,300 ($5,634,700 + $2,154,600). The total cost burden of $5,660,000 = $4,655,000 + $1,005,000. See supra notes 499 and 501. The commenter asserts without further elaboration that "the total cost for the industry would be over $16 million." See Markit Letter at 34. To the extent that the commenter is referring to Rule 606(b)(3) disclosures, for all the reasons discussed above, the Commission believes that it has reasonably estimated the total industry cost as $13,449,300 ($7,789,300 monetized hourly burden + $5,660,000 cost burden).

b. Annual Reporting and Recordkeeping Burden

i. Baseline Burden

The Commission preliminarily estimated that 135 of the 200 broker-dealers that handle orders subject to the customer-specific disclosures required by Rule 606(b)(3) would respond to customer requests in-house.[511] The Commission estimated that an average response to a Rule 606(b)(3) request for a broker-dealer that responds to such requests in-house would take approximately 2 hours per response.[512] The Commission estimated that an average broker-dealer will receive approximately 200 requests annually.[513] Therefore, on average, a broker-dealer that responds to 606(b)(3) requests in-house would incur an estimated annual burden of 400 hours to prepare, disseminate, and retain responses to customers required by Rule 606(b)(3).[514] The Commission preliminarily estimated that 135 broker-dealers that handle orders subject to the customer-specific disclosures required by Rule 606(b)(3) that would respond to requests in-house, and that the total annual burden for such broker-dealers to comply with the customer response requirement in proposed Rule 606(b)(3) would be 54,000.[515]

The Commission preliminarily estimated that 65 broker-dealers that handle orders subject to the customer-specific disclosures required by Rule 606(b)(3) would use a third-party service provider to respond to requests. For these broker-dealers, the Commission preliminarily estimated an annual burden of 1 hour and $100 per response.[516] With an estimated 200 requests

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511 See Proposing Release, supra note 1, at 49471.

512 See id.

513 This estimate was based on discussions with various industry participants. See id.

514 See id.

515 2 hours per response x 200 responses annually per broker-dealer that handles such orders who will respond to requests in-house x 135 such broker-dealers = 54,000 hours. See id.

516 See id. This burden estimate relates solely to the work a broker-dealer or its third-party data provider would perform to run an individual report on such orders for a particular customer and is therefore not

pursuant to Rule 606(b)(3) per year, the Commission preliminarily estimated that on average, the annual burden for a broker-dealer that uses a third-party service provider to respond to requests pursuant to Rule 606(b)(3) would be 200 hours and $20,000.[517] With an estimated 65 broker-dealers that handle such orders that would respond to Rule 606(b)(3) requests using a third-party-service provider, the Commission preliminarily estimated the total annual burden for such 65 broker-dealers would be 13,000 hours[518] and $1,300,000.[519]

Therefore, the Commission preliminarily estimated the total annual burden for all 200 broker-dealers that handle orders subject to the customer-specific disclosures required by Rule 606(b)(3) to comply with the customer response requirement in proposed Rule 606(b)(3) would be 67,000 hours[520] and $1,300,000.[521]

ii. Burden of Adopted Rule

The Commission estimates the total annual burden for the 200 broker-dealers that handle orders subject to the customer-specific disclosures required by Rule 606(b)(3) to comply with Rule 606(b)(3) to be 67,000 hours and $1,300,000, as it did in the Proposing Release, but is updating the monetized hourly burdens to reflect the latest available labor earnings data.

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affected by the following changes from the rule as proposed, which relate to capturing the required data and formatting a report template: (1) the application of Rule 606(b)(3) to NMS stock orders of any size that are submitted on a not held basis, subject to two de minimis exceptions, instead of to "institutional orders" as defined by a dollar-value threshold in the Proposing Release.; (2) the adopted requirement to segment the Rule 606(b)(3) order handling disclosures by directed and non-directed orders; and (3) the elimination of the proposed requirement to segment the Rule 606(b)(3) order handling disclosures by order routing strategy.

517 See id.

518 1 hour per response x 200 responses annually per broker-dealer that will use a third-party service provider x 65 such broker-dealers = 13,000 hours. See id.

519 $100 per request x 200 requests annually x 65 broker-dealers that will use a third-party service provider = $1,300,000. See id.

520 See supra notes 515 and 518.

521 See supra notes 519.

The Commission believes that for the 135 broker-dealers that handle orders subject to the customer-specific disclosures required by Rule 606(b)(3) that would respond in-house to customer requests pursuant to Rule 606(b)(3), as adopted, the annual hourly burden to comply would be 54,000 hours.[522] The Commission believes that for the 65 broker-dealers that handle such orders and would use a third-party service provider to respond to requests pursuant to Rule 606(b)(3), as adopted, the total annual burden to comply would be 13,000 hours[523] and $1,300,000.[524]

Therefore, the Commission estimates the total annual burden for all 200 broker-dealers that handle orders subject to the customer-specific disclosures required by Rule 606(b)(3) to comply with the customer response requirement of Rule 606(b)(3), as adopted, to be 67,000 hours[525] and $1,300,000.[526]

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522 See supra note 515. The Commission is updating the monetized hourly burden estimate to reflect the latest available labor earnings data. The monetized hourly burden for the 125 broker-dealers that handle such orders and would respond in-house to customer requests under Rule 606(b)(3) is $10,989,000: (Programmer Analyst for 1 hour at $236 per hour) + (Jr. Business Analyst for 1 hour at $171 per hour) = $407 x 125 such broker-dealers x 200 requests annually. The Commission derived this estimate based on per hour figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013 adjusted to December 2017 values. See supra note 490.

523 See supra note 518. The Commission is updating the monetized hourly burden estimate to reflect the latest available labor earnings data. The monetized hourly burden for the 65 broker-dealers that handle such orders and would engage a third-party to respond to customer requests under Rule 606(b)(3) is $3,939,000: (Compliance Manager for 1 hour at $303 per hour) = $303 x 65 such broker-dealers x 200 requests annually. The Commission derived this estimate based on per hour figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013 adjusted to December 2017 values. See supra note 490.

524 See supra note 519.

525 See supra notes 522 and 523 (54,000 hours + 13,000 hours = 67,000 hours). The total estimated annual monetized hourly burden is $14,928,000 ($10,989,000 + $3,939,000).

526 See supra note 521.

2. Proposed Public Aggregated Report on Orders Subject to the Customer-Specific Disclosures Under Rule 606(b) Not Adopted

As discussed above, the Commission is not adopting the proposed requirement that broker-dealers that handle orders subject to the customer-specific disclosures required by Rule 606(b)(3) issue a quarterly public aggregated disclosure on order handling.[527] The Commission preliminarily estimated an initial and annual burden created by this proposed requirement,[528] but as this requirement is not being adopted, there is no longer an associated cost and hourly burden.

3. Proposed Requirement to Document Methodologies for Categorizing Order Routing Strategies Not Adopted

As discussed above, the Commission is not adopting the proposed requirement that broker-dealers break down information in the disclosures required by Rule 606(b) by order routing strategies.[529] The Commission preliminarily estimated an initial and annual burden created by this proposed requirement,[530] but as this requirement is not being adopted, there is no longer an associated cost and hourly burden.

4. Amendment to Current Public and Customer-Specific Disclosures

a. Initial Reporting and Recordkeeping Burden

i. Baseline Burden

The Commission preliminarily estimated that there are 266 broker-dealers to which the proposed disclosures in Rule 606(a)(1) and (b)(1) would apply.[531] The Commission estimated that the initial burden for a broker-dealer that routes orders subject to the disclosures required by Rule 606(a)(1) whose systems do not currently capture all of the information required by the rule

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527 See supra Section 0.A.0.0.

528 See Proposing Release, supra note 1, at 49471-72.

529 See supra Section 0.A.0.0.0.

530 See Proposing Release, supra note 1, at 49472-74.

531 See id.

to update its systems to capture the information required by proposed Rule 606(a) and format that information into a report to comply with the rule would be 76 hours[532] and the total initial burden for the 25 broker-dealers that the Commission estimated do not currently capture information required by the proposed rule that would perform the necessary system updates in-house would be 1,900 hours.[533]

The Commission estimated that the initial burden for a broker-dealer that routes orders subject to the disclosures required by Rule 606(a)(1) to engage a third-party to program the necessary system updates to comply with proposed Rule would be 20 hours and $10,000[534] and estimated the total initial burden for the 25 broker-dealers that the Commission estimated do not currently capture information required by the proposed rule that would engage a third-party service provider to perform the necessary system updates to both capture the required data and create the reports would be 500 hours[535] and $250,000.[536] The Commission noted that this estimate contemplated the impact of making the reports available using the most recent versions of the XML schema and the associated PDF renderer, as published on the Commission's website, as required by both proposed Rule 606(a) and 606(b)(1), and that the total initial burden estimate

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532 The monetized hourly burden was estimated at $22,648 per broker-dealer. See id. Due to an arithmetic error, the individual hourly burden for each broker-dealer was originally calculated as 80 hours instead of 76 hours, leading to a total burden calculation of 2,000 hours (80 hours x 25 broker-dealers) instead of 1,900 hours (76 hours x 25 broker-dealers). The monetized hourly burden was correctly calculated using a 76-hour figure.

533 The total monetized hourly burden was estimated at $831,075. See Proposing Release, supra note 1, at 49474.

534 See id.

535 The total monetized hourly burden was estimated at $149,625. See Proposing Release, supra note 1, at 49474-75.

536 See id.

for all 50 broker-dealers that the Commission estimated would need to update their systems and create a new report would be 2,400 hours[537] and $250,000.[538]

For the remaining 216 broker-dealers that the Commission estimated already capture the data required by the proposed modifications to Rule 606(a)(1), the Commission estimated that 108 of such broker-dealers already engage a third-party service provider to provide reports pursuant to existing Rule 606(a)(1) and such broker-dealers would continue to use third-party service providers to format reports to comply with proposed Rule 606(a)(1).[539] The Commission estimated that the remaining 108 broker-dealers that already capture information required by the proposed rule would prepare and format a report to comply with the proposed rule in-house.[540] The Commission estimated that for a broker-dealer that already captures such data, the burden to format that data into its existing reports on its own would be 20 hours.[541] Therefore, the Commission estimated the total initial burden for broker-dealers to format already captured data into a report in-house to comply with proposed Rule 606(a)(1) to be 2,160.[542]

The Commission estimated that the initial burden for the 108 broker-dealers that engage a third-party service provider to format reports to comply with proposed Rule 606(a)(1) would be 8 hours[543] and $2,000[544] and that the estimated total initial burden for these broker-dealers to

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537 The total monetized hourly burden was estimated at $715,825. See Proposing Release, supra note 1, at 49475.

538 See id.

539 See id.

540 See id.

541 The monetized hourly burden was estimated at $4,975 per broker-dealer. See id.

542 The total monetized hourly burden was estimated at $537,300. See id.

543 The monetized hourly burden was estimated at $2,555 per broker-dealer. See id.

544 See id.

comply with proposed Rule 606(a) would be 864[545] hours and $216,000.[546] Thus, the Commission estimated that the burden for the 216 broker-dealers for whom the Commission estimated already capture the data required by proposed Rule 606(a) to format their reports to incorporate such data would be 3,024 hours[547] and $216,000.[548] These estimates included the impact of making the reports available using the most recent versions of the XML schema and the associated PDF renderer as published on the Commission's website, as required by both proposed Rule 606(a) and 606(b)(1).[549]

Finally, the Commission estimated that the initial burden for a broker-dealer that routes orders subject to the disclosures required by Rule 606(a)(1) to review, assess, and disclose its payment for order flow arrangements and profit-sharing relationships would be 10 hours and that all 266 broker-dealers that route such orders would describe such agreements and arrangements themselves.[550] Therefore, the Commission estimated the total initial burden for all broker-dealers that route such orders to review, assess, and disclose their payment for order flow arrangements and profit-sharing relationships to be 2,660 hours[551] and $466,000.[552]

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545 The total monetized hourly burden was estimated at $275,940. See id.

546 See id.

547 The total monetized hourly burden was estimated at $813,240. See id.

548 See id.

549 See id.

550 See Proposing Release, supra note 1, at 49475-76.

551 The total monetized hourly burden was estimated at $839,230. See Proposing Release, supra note 1, at 49476.

552 See Proposing Release, supra note 1, at 49475.

Therefore, the Commission estimated that the total initial burden to comply with the proposed modifications to Rule 606(a)(1) for all 266 broker-dealers would be 8,084 hours and $2,408,730.[553]

ii. Burden of Amended Rule

As discussed above, based on more recent data on respondents,[554] the Commission now estimates that 292 broker-dealers are engaged in the practice of routing orders subject to the disclosures required by Rule 606(a)(1). Additionally, the Commission is revising its burden and cost estimates associated with the initial burdens of producing the reports on such order routing. As discussed above,[555] a commenter criticized the Commission's estimate of both the hourly burden and the monetized burden associated with producing the disclosures, but did not explicitly state to which category of disclosures – Rule 606(a)(1) or Rule 606(b)(3) – the comments applied.[556] The Commission is revising its burden estimates for disclosures required under Rule 606(a)(1) and Rule 606(b)(3) primarily to reflect that all broker-dealers, rather than the fractional number the Commission estimated in the Proposal,[557] will have to modify their systems to comply with the rule.[558]

The commenter acknowledges that broker-dealers may either update their systems in-house or engage a third-party vendor to make the changes.[559] The Commission believes that it is

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553 See Proposing Release, supra note 1, at 49474-76.

554 See supra Section 0.0.0.

555 See supra Section 0.0.0.0.0.

556 See Markit Letter at 33.

557 See Proposing Release, supra note 1, at 49474-75.

558 See Markit Letter at 33 ("[i]n order to produce the data for the public reports, brokers will all have to modify their OMS system or have their OMS vendor make changes" (emphasis added)).

559 See Markit Letter at 33 (broker-dealers will have to "modify their OMS system or have their OMS vendor make changes").

reasonable to estimate that one third of the 292 broker-dealers that route orders subject to the disclosures required by Rule 606(a)(1) – 97 broker-dealers – will implement the changes in-house, while the remaining number – 195 broker-dealers – will engage a third-party vendor to do so.[560]

The commenter criticizes the Commission's hourly burden estimate for producing the Rule 606(a)(1) disclosures as too low and suggests an estimate of 240 hours to produce the reports.[561] Additionally, the commenter suggests that the Commission's estimate may not have considered the costs associated specifically with implementation of systems to allow marketability of orders to be determined[562] to comply with the requirement that the Rule 606(a)(1) disclosures segment reporting on limit orders into marketable and non-marketable.[563]

Upon consideration of the comments, and in particular the statement that the implementation would require "at least [] four weeks of developer time," [564] and result in a "total cost of 240 hours per broker,"[565] the Commission is revising its initial hourly burden estimate for

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560 As discussed above, the Commission is revising its burden estimates for Rule 606(a)(1) to reflect that all broker-dealers that route orders subject to the rule, rather than the fractional number the Commission estimated in the proposal, will have to modify their systems to comply with the rule. When the Commission estimated in the proposal this fractional number of broker-dealers, it estimated that half this number would implement the requirements of the rule in-house and the other half would engage a third-party service provider to do so. See Proposing Release, supra note 1, at 49474-75. Now that the Commission is estimating all 292 broker-dealers will have to modify their systems to comply with the rule, rather than a fractional amount, it believes that, consistent with the proportions relating to Rule 606(b)(3) system implementation discussed above, one-third of broker-dealers will implement the changes in-house and two-thirds will engage a third-party service provider, because in-house implementation costs are generally higher than outsourcing, and a proportion of broker-dealers greater than one-half will want to realize the cost savings. See supra note 496. Accordingly, the Commission is revising the proportion of in-house and third-party system implementation relating to Rule 606(a)(1) to one-third and two-thirds of all 292 broker-dealers, respectively, consistent with its estimates for Rule 606(b)(3) system implementation.

561 See Markit Letter at 33.

562 See Markit Letter at 33-34.

563 See supra Section 0.0.0.

564 See Markit Letter at 33. The Commission is revising its initial estimate of 20 Sr. Programmer hours to 160 Sr. Programmer hours = 40-hour work week x 4 ("four weeks of developer time").

565 See id.

a broker-dealer that routes orders subject to the requirements of Rule 606(a)(1) to both update its data capture systems in-house and format the report required by the rule to 240 hours.[566] The Commission believes the initial hourly burden for broker-dealers that route such orders to engage a third-party to implement the requirements of the rule to be 20 hours[567] but is revising the associated costs to $32,000 to reflect the complexities associated with implementing the marketability requirement raised by the commenter.

The Commission is estimating the total initial burden for broker-dealers that will program their systems in-house to capture the data and produce a report to comply with the rule as 23,280 hours.[568] The Commission is estimating the total initial burden for broker-dealers that will engage a third-party vendor to program their systems to capture the data and produce a report to comply with the rule as 3,900 hours[569] and $6,240,000.[570]

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566 The Commission estimates the monetized burden for this requirement to be $76,800. (Sr. Programmer for 160 hours at $324 per hour) + (Sr. Database Administrator for 20 hours at $334 per hour) + (Sr. Business Analyst for 20 hours at $269 per hour) + (Attorney for 4 hours at $407 per hour) + (Sr. Operations Manager for 20 hours at $358 per hour) + (Systems Analyst for 16 hours at $257 per hour) = 240 hours and $76,800. The Commission derived this estimate based on per hour figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013 adjusted to December 2017 values. See supra note 490.

567 See supra note 534. The Commission is updating the monetized hourly burden estimate to $6,410 to reflect the latest available labor earnings data. (Sr. Business Analyst for 5 hours at $269 per hour) + (Compliance Manager for 10 hours at $303 per hour) + (Attorney for 5 hours at $407 per hour) = 20 hours and $6,410. The Commission derived this estimate based on per hour figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013 adjusted to December 2017 values. See supra note 490.

568 23,280 hours = 240 hours x 97 broker-dealers that route such orders and would perform the necessary programming upgrades in-house. The monetized hourly burden is $7,449,600 = $76,800 x 97 such broker-dealers. See supra note 566.

569 3,900 hours = 20 hours x 195 broker-dealers that route such orders and would engage a third-party vendor to perform the necessary programming upgrades. The monetized hourly burden is $1,249,950 = $6,410 x 195 such broker-dealers. See supra note 567.

570 $32,000 per broker-dealer that will need to engage a third-party vendor x 195 such broker-dealers) = $6,240,000.

Therefore, the Commission estimates that the total initial burden for all 292 broker-dealers to comply with Rule 606(a)(1), as amended, and format their reports to incorporate such data[571] is 27,180 hours and $6,240,000.[572]

The Commission includes in this estimate the initial burden of making the reports available using the most recent versions of the XML schema and the associated PDF renderer as published on the Commission's website, as required by Rule 606(a) and (b)(1), as amended.

Finally, the Commission estimates that the initial burden for a broker-dealer that routes orders subject to the disclosures described by Rule 606(a)(1) to review, assess, and disclose its payment for order flow arrangements and profit-sharing relationships to be 10 hours[573] and is updating the monetized burden estimate to $3,380 to reflect the latest available labor earnings data.[574] The Commission believes that all broker-dealers that route such orders would describe such agreements and arrangements themselves.[575] To reflect the latest available respondent

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571 As discussed above, the Commission is adopting a new requirement to divide the reports required by Rule 606(a) by two categories: "S&P 500 Index" and "Other NMS Stocks." See supra Section 0.0.0. The Commission believes that broker-dealer systems already capture information on the securities listed in the S&P 500 Index, so this requirement imposes no additional burden associated with data capture. With respect to formatting the report, the Commission believes that the work of segmenting data by a condition or removing such segmentation generally carries the same burden, independent of the segmenting condition. Since the Commission believes that the burden of removing segmentation by listing market, a requirement which is being eliminated, is similar to the burden of the new requirement to segment the data by S&P 500 membership, the net burden remains unchanged. Therefore, this requirement does not change the initial or ongoing hourly burden as estimated in the proposing release.

572 See supra notes 568, 569, and 570 (23,280 hours + 3,900 hours = 27,180 hours). The total estimated initial monetized hourly burden is $8,699,550 ($7,449,600 + $1,249,950). The commenter asserts without further elaboration that "the total cost for the industry would be over $16 million." See Markit Letter at 34. To the extent that the commenter is referring to Rule 606(a) and 606(b)(1) disclosures, for all the reasons discussed above, the Commission believes that it has reasonably estimated the total industry cost as $14,939,550 ($8,699,550 monetized hourly burden + $6,240,000 cost burden).

573 See supra note 550.

574 The Commission derived this estimate based on per hour figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013: (Sr. Business Analyst at $269 per hour for 5 hours) + (Attorney at $407 per hour for 5 hours) = 10 hours and $3,380. The Commission derived this estimate based on per hour figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013 adjusted to December 2017 values. See supra note 490.

575 See Proposing Release, supra note 1, at 49475-76.

numbers, the Commission estimates the total initial burden for all 292 broker-dealers that route such orders to review, assess, and disclose its payment for order flow arrangements and profit-sharing relationships to be 2,920 hours.[576]

As discussed above, Rule 606(b)(1), as amended, does not modify any of the current customer-specific disclosure requirements but modifies the categories of orders to which the disclosure applies. Prior to these amendments, Rule 606(b)(1) applied to all customer orders, i.e., orders not from the account of a broker-dealer that are NMS stock orders having a market value of less than $200,000 and orders having a market value of at least $50,000 for an NMS security that is an option contract. However, broker-dealers must now modify their systems to provide the disclosures for the following types of orders not from a broker-dealer, regardless of market value: (i) orders in NMS stocks that are submitted on a held basis; (ii) orders in NMS stocks that are submitted on a not held basis and are exempt from the disclosure requirements of Rule 606(b)(3); or (iii) orders in NMS securities that are option contracts.

The Commission believes that it is reasonable to estimate that one third of the 292 broker-dealers that route orders subject to the disclosures required by Rule 606(b)(1) – 97 broker-dealers – will implement these changes in-house, while the remaining number – 195 broker-dealers – will engage a third-party vendor to do so.[577] The Commission estimates the initial burden for a broker-dealer that will program its systems in-house to comply with Rule 606(b)(1) as 24 hours.[578] The Commission estimates the initial burden for a broker-dealer that

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576 10 hours per broker-dealer that routes such orders x 292 such broker-dealers = 2,920 hours. The Commission estimates the monetized burden for this requirement to be $986,960 ($3,380 per broker-dealer that routes such orders x 292 such broker-dealers). See id.

577 See supra note 560.

578 The Commission estimates the monetized burden for this requirement to be $6,826. (Programmer for 16 hours at $265 per hour) + (Sr. Database Administrator for 2 hours at $334 per hour) + (Sr. Business Analyst for 2 hours at $269 per hour) + (Attorney for 1 hour at $407 per hour) + (Sr. Operations Manager

will engage a third-party vendor to program its systems to comply with the rule as 3 hours[579] and $5,000.[580]

Therefore Commission estimates the total initial burden for all 292 broker-dealers to program their systems to comply with Rule 606(b)(1) as 2,913 hours[581] and $975,000.[582]

b. Annual Reporting and Recordkeeping Burden

i. Baseline Burden

The Commission preliminarily believed that broker-dealers would need to monitor payment for order flow and profit-sharing relationships and potential SRO rule changes that could impact their order routing decisions and incorporate any new information into their reports. Thus, the Commission estimated the average annual burden for a broker-dealer to comply with the proposed amendments to Rule 606(a)(1)(i) through (iii) would be 10 hours and the total annual burden for all broker-dealers to comply with the proposed amendments would be 2,660 hours.[583]

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for 2 hours at $358 per hour) + (Systems Analyst for 1 hour at $257 per hour) = 24 hours and $6,826. The Commission derived this estimate based on per hour figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013 adjusted to December 2017 values. See supra note 490.

579 The Commission estimates the monetized burden for this requirement to be $979. (Sr. Business Analyst for 1 hour at $269 per hour) + (Compliance Manager for 1 hour at $303 per hour) + (Attorney for 1 hour at $407 per hour) = 3 hours and $979. The Commission derived this estimate based on per hour figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013 adjusted to December 2017 values. See supra note 490.

580 The Commission estimates that a third-party service provider would charge an average of $5,000 to upgrade a broker-dealer's systems to comply with proposed Rule 606(b)(1).

581 2,913 hours = (24 hours x 97 broker-dealers that route such orders and would perform the necessary programming upgrades in-house) + (3 hours x 195 broker-dealers that would engage a third-party to perform the upgrades). The monetized hourly burden is $853,027 = ($6,826 x 97 broker-dealers that would perform the upgrades in-house) + ($979 x 195 broker-dealers that would engage a third-party to perform the upgrades). See supra notes 578 and 579.

582 $5,000 per broker-dealer that will need to engage a third-party vendor x 195 such broker-dealers) = $975,000. See supra note 580.

583 See Proposing Release, supra note 1, at 49476.

Finally, the Commission estimated that the average annual burden for a broker-dealer that handles retail orders to describe and update any terms of payment for order flow arrangements and profit-sharing relationships with a Specified Venue that may influence their order routing decisions, as required by proposed Rule 606(a)(1)(iv), would be 15 hours.[584] With 266 broker-dealers involved in retail order routing practices that would be required to comply with the rule, the Commission estimated the total annual burden for complying with proposed Rule 606(a)(1)(iv) would be 3,990 hours.[585]

ii. Burden of Amended Rule

The Commission continues to believe that the annual burden to produce a quarterly report will remain the same under Rule 606(a), as amended, as under the previous rule but that all broker-dealers that route retail orders will need to monitor payment for order flow and profit-sharing relationships and potential SRO rule changes that could impact their order routing decisions and incorporate any new information into their reports. The Commission continues to estimate the average annual burden for a broker-dealer to comply with the amendments to Rule 606(a)(1)(i) through (iii), as amended, to be 10 hours[586] and is updating the monetized burden estimate to $3,380 to reflect the latest available labor earnings data.[587] To reflect the latest

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584 See id.

585 See id.

586 See supra note 583.

587 The Commission derived this estimate based on per hour figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013 adjusted to December 2017 values, see supra note 490: (Sr. Business Analyst at $269 per hour for 5 hours) + (Attorney at $407 per hour for 5 hours) = 10 hours and $3,380.

available respondent numbers, the Commission estimates the total annual burden for all 292 broker-dealers required to perform this monitoring to be 2,920 hours.[588]

The Commission continues to estimate the average annual burden for a broker-dealer required to describe and update any terms of payment for order flow arrangements and profit-sharing relationships with a Specified Venue that may influence their order routing decisions, as required by Rule 606(a)(1)(iv), as amended to be 15 hours[589] and is updating the monetized burden estimate to $3,745 to reflect the latest available labor earnings data.[590] To reflect the latest available respondent numbers, the Commission estimates the total annual burden for all 292 broker-dealers required to comply with Rule 606(a)(1)(iv), as amended, to be 4,380 hours.[591]

5. Revisions to Compliance Manuals

As discussed above, the amendments being adopted today add several defined terms to Rule 600 of Regulation NMS which will impose an initial burden on market centers and the broker-dealers to review and update compliance manuals and written supervisory procedures and update citation references to any such defined term. Although the Commission did not include an initial estimate for this burden in the Proposing Release, the Commission is now revising its PRA estimate to include this burden. Based on its familiarity with these types of materials and the likelihood that these materials are maintained in an electronic form that facilitates search and replace, the Commission estimates that each of the 381 market centers and 4,024 broker-dealers

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588 10 hours per broker-dealer that routes such orders x 292 such broker-dealers = 2,920 hours. The Commission estimates the monetized burden for this requirement to be $986,960 ($3,380 per broker-dealer that routes such orders x 292 such broker-dealers). See id.

589 See Proposing Release, supra note 1, at 49476.

590 The Commission derived this estimate based on per hour figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013, see supra note 490: (Jr. Business Analyst at $171 per hour for 10 hours) + (Attorney at $407 per hour for 5 hours) = 15 hours and $3,745.

591 15 hours annually per broker-dealer that routes such orders x 292 such broker-dealers = 4,380 hours. The Commission estimates the total monetized burden for this requirement to be $1,093,540. ($3,745 annually per broker-dealer that routes such orders x 292 such broker-dealers). See id.

would make these updates in house at a one-time burden of 2 hours for each respondent.[592] Therefore the Commission estimates the total initial cost to be 8,810 hours.[593] There is no annual burden associated with this requirement.

6. Amendment to Disclosures under Rule 605

The amendment to Rule 605 being adopted today requires that such reports be kept posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website. Because reports were already required to be posted to a website pursuant to Rule 605 prior to today's amendments, and the proposed amendment merely prescribes a minimum period of time for which such reports shall remain posted, the Commission preliminarily estimated the proposed amendment to Rule 605 would not impose an additional burden.[594] The Commission continues to believe that this amendment will not impose an additional collection burden.

E. Collection of Information is Mandatory

All of the collections of information are mandatory.

F. Confidentiality of Responses to Collection of Information

To the extent that the Commission receives confidential information pursuant to the collection of information, such information will be kept confidential, subject to the provisions of

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592 The Commission estimates the monetized burden for this requirement to be $426. (Paralegal for 2 hours at $213 per hour) = 2 hours and $426. The Commission derived this estimate based on per hour figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013 adjusted to December 2017 values. See supra note 490.

593 2 hours x (381 market centers + 4,024 broker-dealers) = 8,810 hours. The Commission estimates the total monetized burden for this requirement to be $1,876,530. ($426 per market center or broker-dealer that routes such orders x (381 market centers + 4,024 broker-dealers)). See id.

594 See Proposing Release, supra note 1, at 49476.

applicable law.[595] Any information required to be disclosed publicly by the amended Rules would not be confidential.

The quarterly order routing reports prepared and disseminated by broker-dealers pursuant to Rules 606(a), as amended, would be available to the public. The individual responses by broker-dealers to customer requests for order routing information required by Rules 606(b)(1) and (b)(3), as amended, would be made available the customer. The Commission, SROs, and other regulatory authorities could obtain copies of these reports as appropriate.

G. Retention Period for Recordkeeping Requirements

Pursuant to Rule 606(a), as amended, broker-dealers shall be required to keep quarterly order routing reports posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website.

For Rule 606(b), as adopted, broker-dealers shall be required to preserve all communications required under these proposed amendments pursuant to Rule 17a-4, as applicable.[596]

Pursuant to the proposed amendments to Rule 605, as amended, market centers shall be required to keep order execution reports posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website.

V. Economic Analysis

The Commission is sensitive to the economic consequences and effects, including costs and benefits, of its rules. The following economic analysis identifies and considers the costs and

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595 See, e.g., 5 U.S.C. 552 et seq.; 15 U.S.C. 78x (governing the public availability of information obtained by the Commission).

596 17 CFR 240.17a-4. Registered brokers and dealers are already subject to existing recordkeeping and retention requirements under Rule 17a-4.

benefits — including the effects on efficiency, competition, and capital formation — that may result from the amendments to Rules 600, 605, and 606.[597] These costs and benefits are discussed below and have informed the policy choices described throughout this release.

A. Introduction

Among the primary economic considerations for the adopted amendments to Rule 600, Rule 605, and Rule 606 are transparency for customers placing not held NMS stock orders, transparency for customers placing held NMS stock orders, and enhanced access to order handling reports.[598]

The Commission believes that requiring customer-specific order handling disclosures for orders submitted on a not held basis, as will be required by adopted Rule 606(b)(3), will provide information to customers to enable them to assess broker-dealers' order handling decisions and to incentivize broker-dealers to better manage any potential conflicts of interest the broker-dealers may face, provide customers with higher-quality routing services, and promote competition.

The Commission is also amending Rule 606(b)(1) to require a broker-dealer, upon customer request, to provide disclosures for orders in NMS stock that are submitted on a held basis, and for orders in NMS stock that are submitted on a not held basis and for which the broker-dealer is not required to provide the customer a report under Rule 606(b)(3). The Commission believes that amended Rule 606(b)(1) disclosures will help ensure customers can assess the order routing and execution quality provided by their broker-dealers, which, in turn,

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597 The Commission also is adopting amendments to Rule 3a51-1(a) under the Exchange Act; Rule 13h-1(a)(5) of Regulation 13D-G; Rule 105(b)(1) of Regulation M; Rules 201(a) and 204(g) of Regulation SHO; Rules 600(b), 602(a)(5), and 611(c) of Regulation NMS; and Rule 1000 of Regulation SCI, to update cross-references as a result of the amendments being adopted today, which would not result in costs or benefits.

598 See supra Section 0.

enables the customers to evaluate and select broker-dealers, promote competition among broker-dealers, and support overall market efficiency.

The Commission also is amending Rule 606(a) such that the public reports include additional information that will enhance transparency on the routing of customer orders and enhance competition among broker-dealers that route such orders, to the benefit of investors.

The Commission believes that the requirement that the order routing reports required by Rule 606(b) be provided in a consistent, structured format will be useful to customers as such format will allow customers to more easily analyze and compare data across broker-dealers.

Finally, the Commission believes that the amendments to Rules 605 and 606 of Regulation NMS to require that the public order execution and order routing reports be kept publicly available for a period of 3 years will allow the public to more efficiently evaluate the services of broker-dealers because it will be easier for the public to access historic reports and analyze the data over an extended time period.

The Commission believes that these adopted amendments as a whole will allow customers to better assess the held NMS stock order routing and execution quality offered by their broker-dealers. As a result, the Commission believes that these additional disclosures may provide broker-dealers further incentives to improve execution quality for their customers and better manage any potential for conflicts of interest the broker-dealers may face. In addition, the ability of customers to better assess routing and execution quality could also lead to increased competition among broker-dealers with respect to execution quality, which could, in turn, result in broker-dealers providing even higher-quality order routing and execution services.

The discussion below presents a baseline of the current practices, a consideration of the costs and benefits of the adopted new requirements, alternatives considered, and a discussion of the potential effects of the adopted amendments.

B. Baseline

The baseline for considering the economic impact of amending Rule 606 to require reporting for not held NMS stock orders consists of: (1) information that customers currently receive from their broker-dealers regarding how their not held NMS stock orders are handled; (2) the format in which such information is currently provided to customers; (3) conflicts of interest broker-dealers currently face; (4) the current use of actionable IOIs; and (5) the ability to assess order routing and execution quality currently provided by different broker-dealers and execution quality currently provided by different trading centers.

The baseline for considering the economic impact of amending Rule 606 for held NMS stock orders and of amending Rule 605 consists of: (1) information that customers currently receive under Rules 605 and 606 or information that customers currently receive from their broker-dealers that is not required by Rules 605 and 606; (2) the format in which information required by Rule 606 for such orders is provided to customers; (3) conflicts of interest that broker-dealers currently face; (4) how long reports required by Rules 605 and 606 are available to the public; and (5) the ability to assess order routing and execution quality currently provided by different broker-dealers and execution quality currently provided by different trading centers.

Finally, the baseline for considering the economic impact of amending Rules 605 and 606 includes the current competitive landscape in the markets for brokerage services and for execution services and any current limitations on efficiency or capital formation relevant to the adopted amendments. These various baseline factors are discussed in further detail below.

1. Current $200,000 Threshold

Currently, Rule 606 of Regulation NMS requires public disclosure of a broker-dealer's order routing information for non-directed orders in NMS securities that are in amounts less than (i) $200,000 for NMS stocks, and (ii) $50,000 for option contracts.[599] While market participants have access to publicly available order execution quality statistics and order routing information for these smaller orders,[600] there is no public disclosure requirement for larger orders.

In the Proposing Release, the Commission analyzed how the $200,000 relates to orders from institutional customers.[601] With respect to orders from institutions, Commission staff reviewed a set of orders from institutions and found that 83.2% of orders studied were smaller than $200,000 as discussed in the Proposing Release.[602] However, 92% of total dollar volume from orders of institutions in the data has a market value of at least $200,000. As also discussed in the Proposing Release, the percentage of orders from institutions that have a market value of $200,000 varies by activity level of the stock, with a higher proportion having a market value of

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599 See 17 CFR 242.606. See also supra note 4 and accompanying text.

600 Rule 605 requires a market center that trades NMS stocks to make available to the public monthly electronic execution reports that include uniform statistical measures of execution quality. The Commission staff exempted from the rule any order with a size of 10,000 shares or greater. See Letter to Darla C. Stuckey, Assistant Secretary, New York Stock Exchange, Inc., from Annette L. Nazareth, Director, Division, dated June 22, 2001.

601 See Proposing Release supra note 1, at 49483.

602 See id. Information on institutional equity trading for the sample period of 2013-2014 is obtained from Abel Noser Solutions, Ltd. According to an academic study by Puckett and Yan (2011), the dataset contains detailed equity trading information for each Abel Noser client and includes a representative set of institutional investors including pension plan sponsors (e.g., CalPERS, the Commonwealth of Virginia, and YMCA retirement fund) and money managers (e.g., Massachusetts Financial Services (MFS), Putnam Investments, and Lazard Asset Management). The authors also reported that the database contains a total of 840 different institutions during their sample period. These clients accounted for at least 10% of the total trading volume from 1999-2005, according to Puckett and Yan (2011). The Commission assumes for purposes of this analysis that these clients have continued to account for at least this volume during its sample period. See, e.g., Andy Puckett and Xuemin (Sterling) Yan, The Interim Trading Skills of Institutional Investors, 66 Journal of Finance 601 (April 2011).

$200,000 in more active stocks.[603] While approximately 20% of orders from institutions in the group of most active stocks have a market value of $200,000, less than 3% of orders from institutions in the group of least active stocks have a market value of $200,000.

Several commenters also discussed the relationship between the $200,000 threshold and institutional orders and also found that most institutional orders are for trade sizes smaller than $200,000. One commenter stated that its internal analysis of institutional trading volume indicated that 14% of institutional shares and 65% of institutional orders in the month of April 2016 were for less than $200,000, and from a sampling of large retail broker customer orders for 10 trading days in April 2016, over 10% of shares traded and over 20% of the value traded were from orders larger than $200,000.[604] Another commenter stated that approximately 35% of orders it sends to broker-dealers are less than $200,000.[605] Another commenter stated that for January through August 2016 96% of its orders were below the $200,000 threshold.[606]

2. Current Reporting for NMS Stock Orders of $200,000 and Above

Currently, as discussed in the Proposing Release, broker-dealers may voluntarily provide some information on routing and execution quality of NMS stock orders of $200,000 and above to individual customers in response to requests by these customers.[607] Customers may also use third-party vendors for Transaction Cost Analysis ("TCA") to analyze the execution prices of orders compared to various benchmarks; however, TCA as provided by third-party vendors may

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603 See id.

604 See Markit Letter at 6-7.

605 See Capital Group Letter at 2.

606 See Bloomberg Letter at 11-12.

607 See Proposing Release, supra note 1, at 49478-79.

not encompass an analysis of routing decisions as third-party vendors, similar to customers, do not have access to order handling information necessary to do so.

The Commission further understands that reports that customers sending orders of at least $200,000 in market value currently receive upon request from their broker-dealers may not provide the consistent and standardized information needed to fully assess or compare the performance of their broker-dealers.[608] Moreover, customer orders having a market value of at least $200,000 are not subject to public reporting, which creates more difficulty to customers in comparing broker-dealers and assessing broker-dealers' order routing practices.[609]

Even if a broker-dealer voluntarily provides information about NMS stock orders of $200,000 and above upon request, it may not do so with respect to all customers. Whether a given customer receives a report and how responsive the report is to the request likely depends on the customer's current or potential business relationship with the broker-dealer. A broker-dealer may be more accommodating towards customers that send, or may send in the near future, substantial order flow. This difference in access to reports from broker-dealers, and variations in the quality of reports received, may result in a non-level playing field with respect to order handling information.

3. Publication Period for Reports Required by Rules 605 and 606

While Rules 605 and 606 have not specified the minimum length of time that order execution reports and order routing reports are publicly posted, generally, when new reports are available, some market centers and broker- dealers will remove the previous report from their

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608 See Proposing Release, supra note 1, at 49479 for explanation.

609 See id.

website and replace it with their most recent report,[610] and others may make reports available for a longer period of time that varies.[611] The Commission understands that this may make it difficult for the public to compare the order routing decisions of a broker-dealer or the execution quality of market centers through time. Alternatively, the public may rely on third-party vendors who retrieve and aggregate Rule 605 and 606 reports from market centers and broker-dealers, respectively, to get access to historical data.

4. Available Information on Conflicts of Interest

As discussed in the Proposing Release, Rule 606(a) requires that broker-dealers provide for covered orders, among other things, a description of any arrangement for payment for order flow[612] and any profit-sharing relationships.[613]

Many commenters agreed with the baseline that payment for order flow, fees, and rebates could result in conflicts of interest in institutional order routing.[614] One commenter mentioned that investors cannot properly assess the full extent of a broker-dealer's conflicts of interest and the effect that conflicts have on routing decisions absent more detailed explanations of the

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610 See, e.g., Morgan Stanley Rules 605 and 606 Disclosures, available at http://www.morganstanley.com/institutional-sales/sec_rules_605_606; Wells Fargo Legal Disclosures, available at https://www.wellsfargoadvisors.com/disclosures/legal- disclosures.htm; Charles Schwab Order Routing, available at http://www.schwab.com/public/schwab/nn/legal_compliance/important_notices/order_ro uting.html; TD Ameritrade Disclosures, available at https://www.tdameritrade.com/disclosure.page; Fidelity Quarterly Reports, available at https://capitalmarkets.fidelity.com/app/item/RD_13569_21696.html.

611 See, e.g., UBS Order Routing Disclosure, available at https://www.ubs.com/us/en/wealth/misc/orderroutingdisclosure.html.

612 In addition, Rule 10b-10 under the Exchange Act requires broker-dealers, when acting as agent for the customer, to disclose on the confirmation of a transaction whether payment for order flow was received and, upon written request of the customer, to furnish the source and nature of the compensation received. See 17 CFR 240.10b-10(a)(2)(i)(C). Accordingly, Rule 10b-10 provides disclosure to a specific customer of whether payment for order flow was received on a particular transaction, while Rule 606 provides public disclosure of any arrangement for payment for order flow and any profit-sharing relationship by requiring a description of such arrangements.

613 See Proposing Release, supra note 1, at 49479-80.

614 See, e.g., Ameritrade Letter at 1; Fidelity Letter at 1; FSR Letter at 1; and MFA Letter at 1-2.

conflict.[615] For the reasons discussed throughout this release and in the Proposing Release, the Commission believes that financial incentives, such as rebates, have the potential to affect how broker-dealers route retail stock orders.[616] Further, as noted above, conflicts of interest may affect institutional orders in ways similar to effects on retail orders. However, for the reasons discussed in the Proposing Release, the ad hoc nature of the order handling disclosures of institutional orders may not be as effective in providing institutions with information they can use efficiently to assess conflicts of interest, because the ad hoc nature of the reports limits the ability of institutions to make comparisons about broker-dealers' conflicts of interest.

5. Available Information on Execution Quality

As described above and in the Proposing Release, under the rules prior to these amendments, broker-dealers have not been required by regulation or incentivized by marketplace practices to provide customers standardized, comparable reports about the handling of their NMS stock orders of at least $200,000 in market value and instead customers may receive ad hoc reports from broker-dealers upon request.[617] As a result, the Commission believes that customers may not be able to compare reliably the order handling performance of their broker-dealers and to evaluate the execution quality of their orders among broker-dealers.

In contrast to the ad hoc nature of reporting for NMS stock orders of at least $200,000 in market value, Rule 606 has required quarterly public reports on customer order routing and disclosure of customer order routing information upon request. However, the previously existing public reports have not required specific information on payment for order flow received,

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615 See CFA Letter at 5.

616 For a discussion of studies regarding potential negative and positive effects of rebates, see Transaction Fee Pilot Proposing Release, supra note 2.

617 See Proposing Release, supra note 1, at 49480.

payment from any profit-sharing relationship received, or transaction rebates and access fees, and they have not been required to separate limit orders into marketable and non-marketable limit orders. Moreover, because Rule 605 reports only cover held orders and previously existing public reports do not distinguish held orders from customer orders, the scope of Rule 605 reports do not directly align with the scope of Rule 606 reports, which limits the ability of customers to assess execution quality of their broker-dealers.

6. Format of Current Reports

As discussed above and in the Proposing Release, broker-dealers provide some information on routing and execution quality of institutional orders in response to requests from institutional customers in a variety of formats. The reports typically are not in a structured format.[618]

7. Quality of Broker-Dealer Routing Practices for Not Held NMS Stock Orders

The Commission does not have data to gauge the current level of quality of broker-dealer routing practices for not held NMS stock orders, as Rule 606 requires public disclosure of a broker-dealer's order routing information for non-directed orders in NMS securities that are in amounts less than $200,000 for NMS stocks, and does not require broker-dealers to separately report routing of not held orders.[619]

8. Use of Actionable IOIs

To encourage additional order flow, some broker-dealers use actionable IOIs to communicate to external liquidity providers that they have unexecuted liquidity. As noted above

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618 See Proposing Release, supra note 1, at 49480-81.

619 As noted above, including in Section 0.0.0, Rule 606 provides information on the quality of broker-dealer routing practices for customer orders; see also Proposing Release, supra note 1, at 49481.

and in the Proposing Release, because actionable IOIs convey information similar to that of an order, a response to an actionable IOI may result in an execution at the venue of the IOI sender.[620] Accordingly, a broker-dealer's use of actionable IOIs creates potential information leakage similar to that of the routing of orders. The Commission does not have data to gauge the current level of use of actionable IOIs by broker-dealers to attract orders to execute against not held NMS stock orders represented by such actionable IOIs. In addition, Rule 606 for customer orders has not required the inclusion of actionable IOIs in the reports.

The Commission recognizes that, although actionable IOIs and conditional orders are similar, many market participants distinguish conditional orders from actionable IOIs because conditional orders require additional negotiation before a trade can be executed.[621] Further, according to comments, conditional orders typically are messages submitted by participants in an anonymous, dark matching platform to confidentially seek a potential counterparty involving a one-to-one interaction, rather than a one-to-many interaction typical of an actionable IOI.

9. Competition, Efficiency, and Capital Formation

The adopted amendments are likely to affect competition among broker-dealers that route both not held and held NMS stock orders. These broker-dealers compete in a segment of the market for broker-dealer services. The Commission discussed market conditions for broker-dealer services in the Proposing Release, including that the market is highly competitive, with

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620 See Proposing Release, supra note 1, at 49481.

621 See, e.g., BIDS Letter at 4-5; Bloomberg Letter at 3-4; Capital Group Letter at 3; FIF Letter at 7; FSR Letter at 7; Markit Letter at 11-12; SIFMA Letter at 6.

most business concentrated among a small set of large broker-dealers and thousands of small broker-dealers competing.[622]

As of December 2016, there were approximately 4,024 registered broker-dealers.[623] Of these, the Commission estimates that 292 broker-dealers route orders in NMS stocks on a held basis that would be subject to the public disclosure requirements of Rule 606(a) or the current customer-specific disclosure requirements of Rule 606(b)(1).[624] The Commission estimates that 200 broker-dealers route institutional orders, all of whom also route retail orders, and that each broker-dealer that routes institutional orders will receive an average of 200 requests for reports pursuant to adopted Rule 606(b)(3) annually.[625] All of these broker-dealers compete for business from retail and institutional customers. The Commission also estimates that for calendar year 2017, 6,111 unique filers filed Form 13F on behalf of 6,580 institutional investment managers. The Commission estimates the number of customers to be approximately this number of institutional investment managers.[626]

Among other factors, broker-dealers may compete for retail and institutional customers by trying to offer them better terms for trading, such as better execution quality. The emergence of discount brokerages has encouraged full-service brokers to compete on price and

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622 See Proposing Release, supra note 1, at 49481-82; see also Securities Exchange Act Release No. 63241 (November 3, 2010), 75 FR 69791, 69822 (November 15, 2010) (Risk Management Controls for Brokers or Dealers with Market Access).

623 See supra note 467.

624 See supra Section 0.0.0.0.0.

625 See supra Section 0.0.0 and note 513.

626 The Commission estimates the number of customers that may place institutional orders as the number of entire 13F filings submitted during the calendar year 2017. In calendar year 2017, 6,580 unique managers filed 13F reports. The Commission recognizes that not all of these institutions necessarily trade NMS stocks. Further, some customers that submit institutional orders may not be 13F institutions. While this estimate may not be precise, the Commission believes that it approximates the number of customers that may be affected by the adopted amendments.

led to the unbundling of research from execution services.[627] In addition, the fragmentation of NMS stock trading into 13 registered exchanges, more than 40 ATSs, and over 200 OTC market makers[628] has contributed to the need for broker-dealers to focus on venue selection in executing orders. Broker-dealers may also innovate to attract new customers by, for example, offering access to algorithms designed to match trading or investment objectives. However, as noted above, the information on which broker-dealers offer better terms of trade may be non-standardized, may be presented inconsistently over time, or may employ complex calculations using undisclosed methods.[629] Further, the format of the reports may limit the comparison of reports across broker- dealers.[630] As a result, customers may not be able to efficiently identify which broker-dealers provide better execution quality. This may reduce the incentives for broker-dealers to compete by offering better execution quality or to innovate on execution quality. Without the incentive to compete by offering better execution quality, broker-dealers may route customer orders in ways that do not necessarily promote better execution quality.[631] Such inefficient routing could have effects on the market for trading services.

The market for trading services, which is served by trading centers, relies on competition among these market centers to supply investors with execution services at efficient prices. These market centers, which compete to, among other things, match traders with counterparties,

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627 See Proposing Release, supra note 1, at 49436.

628 See supra Section 0; see also Proposing Release, supra note 1, at 49481.

629 See generally supra Sections 0.0.2, 0.0.5, and 0.0.0.

630 See supra Section 0.0.0. for a discussion of current formats. Broker-dealers provide reports in a variety of formats and a given broker-dealer may use different structures and formats for different customers. This makes it difficult to electronically read reports into a system to compare multiple broker-dealers and conduct statistical analysis across broker-dealers. Differing formats also make it difficult to electronically search across broker-dealers for various data points in the reports.

631 See supra Section 0.0.0, regarding the conflicts of interest broker-dealers have when routing customer orders.

provide a framework for price negotiation and provide liquidity to those seeking to trade. As discussed in Section IV.C., the Commission estimates that there are 381 market centers to which Rule 605 applies.[632]

These market centers compete with each other for order flow on a number of dimensions, including execution quality. Their primary customers are the broker-dealers that route their own orders or their customers' orders for execution at the trading center. One way to attract order flow is to offer payment for order flow. The Commission understands that a large portion of retail order flow is sent to internalizers who pay for retail order flow. Trading centers also may innovate to differentiate themselves from other trading centers to attract more order flow. For example, several exchanges recently started pilots in an attempt to attract more retail order flow.[633] Trading centers also may adjust fees and rebates to incentivize broker-dealers to route more order flow to them. To the extent that broker-dealers route orders for reasons other than execution quality, trading centers may have less of an incentive to compete and innovate on execution quality. This may limit overall execution quality and result in higher transaction costs for customers than will exist with greater competition on execution quality.

Transaction costs reflect the level of efficiency in the trading process, with higher transaction costs reflecting less efficiency.[634] Inefficiency in the trading process creates friction,

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632 The 381 market centers estimated for purposes of the PRA include approximately 214 OTC market makers (not including market makers claiming an exemption from the reporting requirements of the Rule), plus 21 exchanges, 1 securities association, 104 exchange market makers, and 41 ATSs. See supra note 469 and accompanying text.

633 See, e.g., Securities Exchange Act Release No. 67347 (July 3, 2012), 77 FR 40673 (July 10, 2012) for the NYSE and NYSEAMER pilots; Securities Exchange Act Release No. 68303 (November 27, 2012), 77 FR 71652 (December 3, 2012) for the CboeBZX pilot; Securities Exchange Act Release No. 71176 (December 23, 2013), 78 FR 79524 (July 30, 2013) for the NYSE Arca pilot; and Securities Exchange Act Release No. 73702 (November 28, 2014), 79 FR 72049 (December 4, 2014) for the BX pilot.

634 See Hans R. Stoll, Friction, 55 Journal of Finance 1479 (2000).

which limits the ability for prices to fully reflect a stock's underlying value.[635] Stoll (2000) defines friction as follows: "[f]riction in financial markets measures the difficulty with which an asset is traded."[636] Stoll follows Demsetz (1968)[637] to "view friction as the price paid for immediacy." Thus, higher transaction costs imply higher friction in the market. Friction makes it more costly to trade and makes investing less efficient. Further, friction limits the ability of arbitrageurs or informed customers to push prices to their underlying values, and thus friction makes prices less efficient.

These frictions may have an adverse impact on capital formation. In particular, an increase in transaction costs may hinder customers' trading activity that would support efficient adjustment of security prices and as a result may limit prices' ability to reflect fundamental values. The resulting less efficient prices result in some issuers experiencing a cost of capital that is higher than if their prices fully reflected underlying values while some other issuers might experience the opposite. This, in turn, may limit efficient allocation and capital formation. If an issuer's cost of capital is higher than in perfectly efficient markets, its projects would appear less profitable than they otherwise would be. The opposite would be true for an issuer with a cost of capital lower than in perfectly efficient markets. Thus, on average, inefficiencies can result in funding projects that generate less capital than some unfunded projects would have.

C. Costs and Benefits

The Commission identified costs and benefits associated with the amendments to Rules 600, 605, and 606, which are discussed below. The Commission quantifies the costs where possible and provides qualitative discussion when quantifying costs and benefits is infeasible.

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635 See id.

636 See id.

637 See Harold Demsetz, The Cost of Transacting, 82 Quarterly Journal of Economics 33 (1968).

Many, but not all, of the costs of the adopted amendments to Rules 600, 605, and 606 involve a collection of information, and these costs and burdens are discussed in the Paperwork Reduction Act Section above, with those estimates being used in the economic analysis below.[638]

1. Customer-Specific Order Handling Disclosures

a. Scope of Customer-Specific Order Handling Disclosure in Rule 606(b)(1) and 606(b)(3), and the De Minimis Exceptions in Rules 606(b)(4) and (b)(5)

i. Benefits

1. Not Held Orders/Rule 606(b)(3)

The Commission believes that the adopted approach to Rule 606(b)(3),[639] based on the distinction between not held and held orders, targets the Rule 606(b)(3) reports to the investors most likely to benefit from them and to the orders in which the reports would be most meaningful. Because of the discretion afforded in the handling of not held orders, the complexity in which not held orders are handled, and the customer-specific nature of instructions for handling not held orders,[640] the granular level of information the Rule 606(b)(3) reports provide for not held orders will be beneficial. Commenters further indicated that retail investor orders are generally held and institutional investor orders are generally not held.[641] The Commission also recognizes that broker-dealers have routing discretion on held orders. However, not held orders allow discretion on additional dimensions such as timing and execution strategy.

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638 See supra Section 0.

639 See Section 0.A.0.0.0.

640 Not held NMS stock orders from customers frequently limit broker-dealer discretion in some manner.

641 See supra note 58.

In light of the comments received suggesting the order type approach, the Commission staff performed a supplemental analysis of that approach. To examine the usage of not held orders by institutional customers, the staff analyzed the percentage of not held orders received from institutional and individual accounts from the FINRA's OATS data.[642] The staff studied orders submitted from customer accounts of 120 randomly selected NMS stocks listed on NYSE during the sample period of December 5, 2016, to December 9, 2016, consisting of 40 large-cap stocks, 40 mid-cap stocks, and 40 small-cap stocks.[643] Consistent with the comments, the staff analysis confirms that orders received from institutional accounts are more likely to be not held orders than orders received from individual accounts. Specifically, the staff analysis found that among the orders received from the institutional accounts, about 69% of total shares and close to 39% of total number of orders in the sample are not held orders, whereas among the orders received from the individual accounts, about 19% of total shares and about 12% of total number of orders in the sample are not held orders. To the extent that institutional investors are generally more sophisticated and in a better position to understand and, therefore, benefit from the Rule 606(b)(3) reports, this result suggests that targeting the not held orders for these customer-specific reports results in the reports being available to those mostly likely to benefit from them. Additionally, because placing not held orders requires an understanding of the price, time, and

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642 The OATS data classifies institutional accounts as defined in FINRA Rule 4512(c) and individual accounts as an account that does not meet the definition of FINRA Rule 4512(c) and is not a proprietary account. In OATS data, "Account Type" identifies the type of beneficial owner of the account for which the order was received or originated. From OATS data, the analysis used orders originated from the following account types only: Individual Customer (I) – An account that does not meet the definition of FINRA Rule 4512(c) and is also not a proprietary account; Institutional Customer (A) – An institutional account as defined in FINRA Rule 4512(c). The analysis also used indicators for order origination from the OATS data. By FINRA definition, order origination identifies whether the order was received from a customer of the firm, originated by the firm, or whether the order was received from another Broker/Dealer. By FINRA definition, F – Order was received from a customer or originated with the Firm; W – Received from another Broker/Dealer. The analysis used orders with the indicator F only.

643 For more details, see OATS Reporting Technical Specifications, available at http://www.finra.org/sites/default/files/TechSpec_062718.pdf.

other discretion embedded in not held orders, those placing not held orders are likely to be relatively sophisticated, even if they are not institutions. Because Rule 606(b)(3) reports will be very detailed, these customers are likely to be among those sophisticated enough to value the information in Rule 606(b)(3) reports and interpret the content of the reports in ways unique to them.[644]

Consistent with commenters, the Commission believes that the adopted approach will facilitate identification of orders by broker-dealers that is consistent with many of the broker-dealers' current practices, which in turn could promote the accuracy of order handling information of not held orders and help ensure the benefits to customers that receive the reports. As noted by multiple commenters, broker-dealers and other market participants are familiar with the held and not held order type classifications, classifying orders as held or not held would be consistent with current industry practice, and the terms held and not held are common terms of usage in the securities markets.[645] Indeed, as pointed out by commenters, broker-dealers already must mark orders that they execute as held or not held, these order classifications are commonly recognized in the FIX Protocol and utilized in OATS technical specifications, the Commission's definition of "covered order" in Rule 600(b)(15) already relies on these order classifications, and broker-dealers already characterize orders on a held or not held basis to comply with Rule 605's covered order requirement and other rules such as FINRA's Manning rule (FINRA Rule 5320).

2. De minimis Exceptions and Rule 606(b)(1)

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644 Some customers give complete discretion to a broker-dealer in handling their orders while other customers may place limits on or provide instructions regarding how a broker-dealer can handle their orders.

645 See Citadel Letter at 3; Markit Letter at 3, 7-8; KCG Letter at 4; Capital Group Letter at 2-3; SIFMA Letter at 3.

The Commission is adopting Rules 606(b)(4) and Rule 606(b)(5) de minimis exceptions from Rule 606(b)(3)'s requirements, which except a broker-dealer from the Rule 606(b)(3) requirements at the firm level or the customer level.[646]

With respect to the Rule 606(b)(4) de minimis, commenters suggested that firms that receive less than 5% of orders from institutions should be exempt from requirements to provide disclosures for institutional orders, both at the individual investor level and in the aggregate,[647] and that the de minimis threshold should closely match a broker-dealer's core business and targeted customer profile.[648] Commenters that supported a de minimis exception from Rule 606(b)(3) also supported disclosure based on whether an order is held or not held and generally discussed the reasoning for a de minimis exception in that context.[649]

To assess commenters' suggestions of a 5% de minimis threshold for Rule 606(b)(3) requirements, the staff conducted a supplemental analysis, which found that among 342 broker-dealers that receive not held orders from customers in the sample data, 28 broker-dealers would receive de minimis exceptions from Rule 606(b)(3)'s requirements.[650] In addition, the analysis found that among all 746 broker-dealers in the sample another 404 broker-dealers did not receive any not held orders from customers and would not be subject to Rule 606(b)(3). Therefore, to the extent that each of these broker-dealers avails itself of the firm-level de minimis exception under Rule 606(b)(4), customers sending not held orders to these broker-dealers may not receive

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646 See supra Section II.A.1.b.iv and note 135.

647 See STA Letter II at 2; Ameritrade Letter at 2; Wells Fargo Letter at 5.

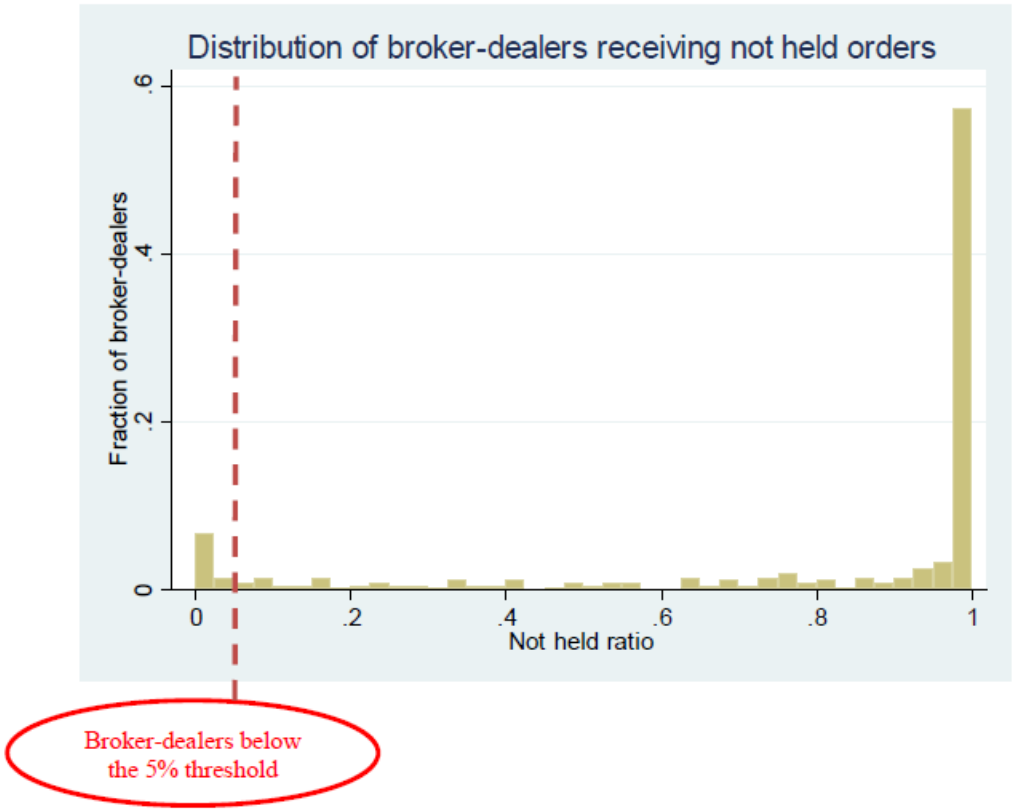
648 See, e.g., Wells Fargo Letter at 5; Citadel Letter at 3; Citadel Letter II at 1-2 (noting that the 5% threshold suggested by other commenters should ensure that smaller broker dealers are not adversely affected by the new disclosure requirement, and noting that a threshold based on a percentage of orders or shares received could potentially be set lower than a threshold based on a percentage of executed shares).

649 See, e.g., FIF Letter at 5, 10; STA Letter II at 2; Citadel Letter at 3; Thomson Reuters Letter at 1; Ameritrade Letter at 2.

650 See supra notes 642 and 643. In addition, 164 broker-dealers receive only not held orders.

Rule 606(b)(3) reports, and also therefore, the benefits of increased transparency of the customer-specific order handling disclosure required by Rule 606(b)(3).[651] However, the Commission believes that the amount of not held orders that will be excluded under the de minimis exception would be minimal. Specifically, the staff analyzed the broker-dealers that are likely to receive the firm-level exception and the amount of not held orders of these broker-dealers.

Figure 1. The distribution of broker-dealers that receive not held orders[652]



Note: The data is from FINRA's OATS data, consisting of 120 randomly selected NMS stocks listed on NYSE during the sample period of December 5, 2016 to December 9, 2016, consisting of 40 large-cap stocks, 40 mid-cap stocks, and 40 small-cap stocks. Not held ratio is calculated by the ratio of not held

651 One commenter stated that a de minimis exception would be inconsistent with the objective of providing a standardized report for all customers, which was one of the Commission's motivations for Rule 606(b)(3). See Bloomberg Letter at 15-16.

652 "Not held ratio (nh ratio)" stands for the ratio of not-held shares to the total shares for each broker-dealer.

shares as a fraction of total shares for each broker-dealer that receives non-zero not held orders in the sample. The horizontal axis is divided by increments of 0.25% of not held ratio.

Figure 1 displays the distribution of broker-dealers that receive not held orders by the ratio of not held shares as a fraction of total shares for each broker-dealer. As Figure 1 indicates, broker-dealers that would meet the firm-level exception because they rarely receive not held orders in relation to held orders are concentrated below the 5% threshold. Specifically, for 23 of the 28 broker-dealers that would meet the firm-level exception, not held orders account for less than 2.5% of each broker's total order receipts.[653] Moreover, as shown in Table 1 below, the supplemental staff analysis found that less than 0.05% of total shares and less than 0.1% of total not held shares in the sample would be excluded from the Rule 606(b)(3) reports by the firm-level de minimis exception, indicating that the amount of not held orders that will be excluded under that exception would be minimal.

Table 1: Number of broker-dealers and volume by not held ratio

Not held ratio	# of broker-dealers	# number of broker-dealers	% of total not held shares	Cum. % of total not held shares	% of Total shares	Cum. % of total shares
0% (only held orders)	404	404	0%	0%	0%	0%
0%< nh ratio<5%	28	432	0.08%	0.08%	0.05%	0.05%
5%<=nh ratio<10%	8	440	0.10%	0.18%	0.06%	0.11%
10%<=nh ratio <15%	4	444	0.29%	0.47%	0.17%	0.28%
15%<=nh ratio <20%	6	450	3.68%	4.16%	2.19%	2.47%
20%<=nh ratio<25%	5	455	0.38%	4.54%	0.23%	2.70%

Further, some firms, for business reasons, may choose to provide the Rule 606(b)(3) order handling disclosures to their customers, regardless of the de minimis exceptions. Further, as discussed in Section III.A.1.vi, broker-dealers that qualify for the firm-level de minimis

653 See Section III.A.1.b.iv supra for a discussion of why a 5% threshold is reasonable in light of the cluster of firms below 2.5%.

exception still must provide, if requested, the Rule 606(b)(1) reports for not held NMS stock orders that they receive from customers, and therefore customers will still receive the benefits of the customer-specific reports required by the adopted amendment to Rule 606(b)(1) discussed below.

The Commission also acknowledges that adopted Rule 606(b)(5)'s customer-level de minimis exception may limit the benefits of Rule 606(b)(3) for some types of customers because some orders that would have been included in the Rule 606(b)(3) reports would be excluded under this de minimis exception.[654] Because, under the customer-level de minimis exception, a broker-dealer will not be obligated to provide the new Rule 606(b)(3) order handling disclosures to any customer that trades on average each month for the prior six months less than $1,000,000 of notional value of not held orders through the broker-dealer, customers sending not held orders less than this threshold will not receive the benefit of Rule 606(b)(3) reports. The Commission also considered that the average and rolling nature of the customer-level de minimis exception may not capture certain customers that exceed the threshold during certain months and not others. As a result, broker-dealers would be required to provide such customers with the Rule 606(b)(3) reports for only some months. However, the months for which the customer might not receive the detailed order handling information in the Rule 606(b)(3) reports are the ones in which the customer was less active. For example, customers could conceivably receive reports eleven months out of the year if they have one month of significant trading volume during a trading year. In this example, the one month excluded from the report would not be a significant part of their overall activity. Moreover, some firms, for business reasons, may choose to provide

[654] Because of the lack of data that would quantify the costs that would result from the customer-level de minimis exception, the Commission provides a qualitative discussion.

the Rule 606(b)(3) order handling disclosures to their customers, regardless of the customer-level de minimis exception. Additionally, as discussed above, broker-dealers still must provide, if requested, the Rule 606(b)(1) disclosures for not held NMS stock orders subject to the customer-level de minimis exception that they receive from customers, and therefore customers could still receive the benefits from the customer-specific reports required by the adopted amendment to Rule 606(b)(1). Further, to the extent that customers receive additional information on broker-dealers' order handling practices and as a result could assess and compare their broker-dealers better, customers may choose to send more not held orders in order to receive Rule 606(b)(3) reports.

The Commission also analyzed how the benefits of Rule 606(b)(1) compare to the scope of rules prior to today's amendments. The Commission believes that amended Rule 606(b)(1) reports are targeting the appropriate orders resulting in the reports being available to those mostly likely to benefit from them. Under the scope of public order handling reports prior to the amendments, customer orders with a market value of less than $200,000 were included in the public order routing reports and broker-dealers would need to prepare Rule 606(b)(1) reports of such orders upon request. In addition, broker-dealers would need to prepare 606(b)(1) reports for orders having a market value of at least $200,000 upon requests under the scope of previously existing reporting requirements. The amended Rule 606(b)(1) requires a broker-dealer, upon customer request, to provide the disclosures set forth in Rule 606(b)(1) for orders in NMS stock that are submitted on a held basis, and for orders in NMS stock that are submitted on a not held basis and for which the broker-dealer is not required to provide the customer a report under Rule 606(b)(3) pursuant to the de minimis exceptions. As discussed in Section III.A.1.b.vi., whereas the Rule 606(b)(3) disclosures are designed primarily for institutional

customers, the Rule 606(b)(1) disclosures that cover held NMS stock orders are more retail customer-focused and thus better aligned with the type of customer most likely to submit held NMS stock orders. The staff's supplemental analysis found that about 25% of shares and about 33% of not held orders in the sample would have received 606(b)(1) reports under the requirements prior to today's amendments but will receive Rule 606(b)(3) reports. As discussed in Section V.C.1.a.i,1., Rule 606(b)(3) reports are more likely to benefit these customers submitting not held orders than Rule 606(b)(1) reports are. A staff's supplemental analysis also showed that about close to 41% of total shares and about 66% of total numbers of orders in the sample would be eligible for the disclosures required by Rule 606(b)(1). As discussed above, because customers sending held orders may have a different level of sophistication to understand the benefits of the 606(b)(1) reports and may have less of a need for the detail and granularity in customer-specific reports, these customers may not frequently request the Rule 606(b)(1) reports. However, as broker-dealers are required to provide Rule 606(b)(1) reports on customers' requests, Rule 606(b)(1) could provide an option to these customers to request additional information if they believe that they would benefit from doing so. As a result, the amended Rule 606(b)(1) could keep the same benefits for such customers by providing them the opportunity to better compare and monitor broker-dealers' order routing practices, which could promote better execution quality of held orders and competition among broker-dealers.

3. Comparison to the Proposal

The Commission also believes that the benefits of the amended scope are greater than the potential benefits of the Proposal, which would have required standardized customer-specific reports on orders of at least $200,000.[655] As discussed below, the Commission believes that the

[655] See Proposing Release, supra note 1, at 49444.

proposed scope, reflected by the proposed definition of institutional order, excluded many institutional orders whereas the adopted scope better targets those likely to benefit from the standardized Rule 606(b)(3) customer-specific reports, provides for more accurate identification of the orders to be included and includes a more comprehensive set of orders in the Rule 606(b)(3) reports.

Relative to the proposed $200,000 threshold, the Commission believes that using not held orders to trigger the Rule 606(b)(3) reports better targets the standardized customer-specific reports to the investors most likely to benefit from them and to the orders in which the reports would be more meaningful. Further, the Commission believes that some investors who are not institutions could benefit from Rule 606(b)(3) reports with respect to orders for which they provide more discretion to their broker-dealers and in which they may provide some unique instructions. The not held order type classification better captures this kind of discretion than does the $200,000 threshold.

While the proposed rule intended to target institutional orders for inclusion in the standardized customer-specific reports required by Rule 606(b)(3), the $200,000 threshold would have excluded most institutional trading. As discussed in the Proposing Release, in a Commission staff analysis, approximately 83.2% of the total number of orders from institutions to buy or sell a quantity of an NMS stock during the calendar year 2013 and 2014 had a market value less than $200,000, and in the least active stocks, less than 3% of orders from institutions would exceed the threshold.[656] Consistent with this staff analysis, multiple commenters indicated that distinguishing retail orders from institutional orders on the basis of the dollar-value threshold would exclude the majority of orders from institutions from the institutional order

[656] See Proposing Release, supra note 1, at 49483.

handling disclosure requirements and include retail orders that fall over the $200,000 threshold within the definition of institutional order.[657] Commenters also stated that because institutional customers break up their orders into smaller child orders, a distinction based on dollar-value threshold would result in inaccurate order identification or duplicate reporting of institutional customer orders as both institutional and retail orders.[658]

The Commission believes that the adopted approach will create greater benefits than the proposed $200,000 threshold because it provides more accurate identification of the orders to be included in the reports for customers. In particular, to the extent that some orders are unpriced and broker-dealers would need to estimate the dollar price of such orders to determine whether they meet the $200,000 threshold, the proposed rule could create misspecification of orders because of estimation error. If broker-dealers incorrectly assign prices to unpriced orders, orders that should have been included in the Rule 606(b)(3) reports would be excluded from those reports, which could create inaccuracies as to which orders would be covered by the Rule 606(b)(3) reports. As a contrast, the distinction based on not held and held order identification will reduce the inaccuracies of the order handling disclosure because all orders, as discussed above, are already marked as not held or held and thus the identification would require no additional processing, which can introduce errors. Moreover, as discussed above, broker-dealers are already familiar with the identification of orders using the not held and held basis, further facilitating the accuracy as to which the intended orders will be covered by the Rule 606(b)(3) reports.

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657 See, e.g., Capital Group Letter at 2; FIF Letter at 3; FIF Addendum at 2; FSR Letter at 3; HMA Letter at 5-6; ICI Letter at 3-7; KCG Letter at 5; Markit Letter at 6-7.

658 See Bloomberg Letter at 11; Citadel Letter at 2; Dash Letter at 3; FIF Addendum at 2; FSR Letter at 4; HMA Letter at 5-6; MFA Letter at 3; SIFMA Letter at 2.

The Commission also believes that the adopted approach will provide more comprehensive 606(b)(3) reports for customers than the proposed $200,000 threshold, thus providing greater benefits to those customers and potentially benefiting more customers. A staff's supplemental analysis found that close to 60% of all shares and close to 34% of the total number of orders in the sample are not held orders and therefore will receive Rule 606(b)(3) reports under the adopted approach, whereas about 45% of all shares and just above 1% of total number of orders in the sample data have a market value of at least $200,000 and therefore would have received Rule 606(b)(3) reports under the proposed rule.[659] The staff analysis suggests that the adopted approach will cover a greater universe of orders in the Rule 606(b)(3) reports relative to the proposed $200,000 threshold.

The Commission believes that the adopted approach will provide benefits to customers placing not held orders having a market value of less than $200,000 whereas the proposed rule would not. The staff's supplemental analysis found that, among the sample orders of less than $200,000, about 45% of the total shares and about 33% of the total number of orders in the analysis were not held orders. These orders were considered as "retail-sized orders" and not entitled to the Rule 606(b)(3) disclosures under the proposed rule. Thus customers sending these orders would not have been entitled the benefit of receiving the Rule 606(b)(3) disclosures. Under the adopted approach, these orders will receive the Rule 606(b)(3) reports. As a result, customers sending not held orders of less than $200,000 in market value will receive the benefits of enhanced transparency in their broker-dealers' order handling disclosure required by Rule 606(b)(3). The Commission therefore believes that customers placing not held orders of less than $200,000 in market value will receive greater benefits as a whole from the Commission's

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659 See supra notes 642 and 643.

adopted approach as compared to the proposed rule because the adopted rule will require broker-dealers to provide detailed and uniform information pursuant to Rule 606(b)(3) for all not held orders regardless of order dollar value.

The Commission acknowledges that the benefits to customers that place held orders with at least $200,000 in market value could be lower under the adopted rule than under the proposed rule. Specifically, held orders having a market value of at least $200,000 will not be included in the standardized customer-specific reports under adopted Rule 606(b)(3), whereas they would have been included under the Proposal. The staff's supplemental analysis found that among orders having a market value of at least $200,000, close to 23% of total shares and about 36% of the total number of orders in the sample will not receive Rule 606(b)(3) reports under the adopted rule, whereas these orders would have been included in the customer-specific reports under the proposed $200,000 threshold. Thus, some customers that send held orders of a market value of at least $200,000 will not benefit from the order handling transparency under Rule 606(b)(3). However, a customer could request the disclosures set forth in Rule 606(b)(1) for these orders, which would maintain the status quo. Also, customers could switch to sending not held orders from held orders in order to receive the benefits of the Rule 606(b)(3) reports, which could result in a worse execution quality for these orders, assuming customers currently optimize their decision on when to request that an order be handled as not held. However, the Commission recognizes that if the benefits of including large held orders in the standardized customer-specific report under adopted Rule 606(b)(3) outweigh the execution quality cost of requesting not held handling of such orders, the customer could submit such orders as not held.

ii. Costs

As discussed in detail below, the Commission recognizes that the scope of orders eligible for the Rule 606(b)(3) reports influences the compliance and other costs of the adopted

amendments. First, broker-dealers will incur costs to ensure the Rule 606(b)(3) reports cover the required orders and to implement the de minimis exceptions set forth in Rule 606(b)(4) and Rule 606(b)(5). The Commission believes the compliance costs associated with identifying not held orders are lower than the compliance costs associated with the proposed $200,000 threshold. In addition, the Commission believes that the two de minimis exceptions will reduce the costs to broker-dealer of producing the customer-specific reports of Rule 606(b)(3), but acknowledges that broker-dealers might incur costs in producing the customer-specific reports in Rule 606(b)(1) for the orders that, due to the de minimis exceptions, are not eligible for the customer-specific reports of Rule 606(b)(3). Further, the Commission acknowledges additional costs that will originate from the uncertainty created by the de minimis exceptions and from potential behavior changes of broker-dealers and customers. The Commission quantifies the costs where possible and provides qualitative discussion when quantifying costs and benefits is not feasible. Many, but not all, of the costs of the adopted amendments to Rules 600, 605, and 606 involve a collection of information, and these costs and burdens are discussed in the Paperwork Reduction Act Section above, with those estimates being used in the economic analysis below.[660]

1. Compliance Costs

The requirement for customer-specific order handling disclosure under Rule 606(b)(3) based on not held or held orders will create compliance costs, as broker-dealers will need to prepare the customer-specific reports for not held orders required by Rule 606(b)(3).[661] The

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660 See supra Section 0.

661 The staff's supplemental analysis found that when all of the orders broker-dealers receive are on a not held basis, about 46% of total shares are less than $200,000. In addition, when the ratio of not held orders that broker-dealers receive from customers is 50% or less excluding broker-dealers receiving a firm-level de minimis exception, about 14% of total shares of orders included in the analysis have a market value of at least $200,000 and are not held orders. As a result, the analysis suggests that the reporting costs could vary depending on the amount of not held orders that the broker-dealers receive.

estimates of the related compliance costs are encompassed in the cost estimates discussed in Section V.C.1.b.ii.3. The adopted approach will create compliance costs for broker-dealers to implement a process to identify not held orders for inclusion in Rule 606(b)(3) reports and for the processing time to screen order data for not held orders when generating the reports.[662] However, the Commission believes that the adopted approach is targeted to moderate compliance burdens. In particular, as discussed in Section V.C.1.a.i, multiple commenters stated that broker-dealers are already familiar with the held and not held order type classifications and orders are already marked as held or not held.[663] Therefore, classifying orders as held or not held would not create other additional implementation or ongoing costs for broker-dealers.

The Commission also acknowledges that the de minimis thresholds in adopted Rules 606(b)(4) and (b)(5) will also create compliance costs to the extent a broker-dealer avails itself of one or both of the exceptions. Specifically, to apply the de minimis thresholds, broker-dealers will need to create systems to identify whether the amount of not held orders broker-dealers receive from customers would meet the threshold of either the firm-level or the customer-level de minimis exception. Broker-dealers will also need to conduct extra data processing to determine whether they or any customers are excepted and to screen out any excepted orders when creating the Rule 606(b)(3) reports.

The amended rule would also impose additional compliance costs on broker-dealers from the requirement set forth in Rule 606(b)(1) prior to today's amendments. As discussed above, Rule 606(b)(1), as amended, requires a broker-dealer, upon customer request, to provide the

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662 The adopted approach will also create initial compliance costs for market centers and the broker-dealers that will have to review and update compliance manuals and written supervisory procedures and update citation references to any such defined term. The estimates of the related compliance costs are encompassed in the cost estimates discussed in Section 0.0.0.

663 See Citadel Letter at 3; Markit Letter at 3, 7-8; KCG Letter at 4; Capital Group Letter at 2-3; SIFMA Letter at 3.

disclosures set forth in Rule 606(b)(1) for orders in NMS stock that are submitted on a held basis, and for orders in NMS stock that are submitted on a not held basis and for which, under the de minimis exceptions, the broker-dealer is not required to provide the customer a report under Rule 606(b)(3). As discussed above, Rule 606(b)(1), as amended, does not modify any of the customer-specific disclosure requirements prior to today's amendments but rather modifies the categories of orders to which the disclosure applies. Under this modification, Rule 606(b)(1) includes held orders and not held orders subject to the de minimis exceptions. Therefore, broker-dealers that receive such orders could incur costs to respond to customer requests as required by Rule 606(b)(1). However, to the extent that broker-dealers already have systems in place to prepare the reports required by the rule prior to these amendments, the amended rule should not create substantial new costs to these broker-dealers to create a new system to prepare Rule 606(b)(1) reports. Additionally, because broker-dealers would need to prepare Rule 606(b)(1) reports only when customers request such reports, and, as discussed above, to the extent that customers typically placing held orders may not value customer-specific reports required by Rule 606(b)(1) and therefore would not frequently request such reports, Rule 606(b)(1) would not impose significant ongoing compliance costs to broker-dealers.

The Commission also analyzed how the compliance costs of the adopted rule compare to the anticipated compliance costs of the proposed rule. Under the adopted approach, broker-dealers will need to prepare Rule 606(b)(3) reports for not held orders of any dollar value, including not held orders with a market value less than $200,000, and will need to, upon request, prepare Rule 606(b)(1) reports for held orders of any dollar value and for not held orders covered by the de minimis exceptions under Rule 606(b)(4) or 606(b)(5). As discussed in Section V.C.1.a.i., the adopted rule will include more orders in the Rule 606(b)(3) reports than under the

proposed rule. The staff's supplemental analysis also found that among the orders of less than $200,000 in the sample data, about 45% of the total shares and about 33% of the total number of orders are not-held.[664] These orders were considered "retail-sized orders" under the proposed rule. Thus, broker-dealers would have not been required to prepare Rule 606(b)(3) reports for these orders, but would have been required to prepare public order routing reports and Rule 606(b)(1) reports upon request. The Commission believes that the adopted approach should moderate processing costs for broker-dealers compared to the proposed rule. To the extent that broker-dealers already have a system to generate Rule 606(b)(1) reports pursuant to the previously existing rule, broker-dealers would need to modify existing systems to prepare Rule 606(b)(3) reports without the need to create entirely new systems to process customer orders. Additionally, as discussed above, broker-dealers that receive an insignificant amount of not held order flows will receive exceptions in preparing for Rule 606(b)(3) reports under Rule 606(b)(4) and 606(b)(5), which could limit the scale of order processing costs on certain broker-dealers to provide Rule 606(b)(3) reports. The Commission also believes that the adopted rule would impose lower implementation and processing costs on broker-dealers relative to the Proposal. To the extent that some orders are unpriced, under the proposed rule broker-dealers would have needed to estimate the current market price of NMS stocks when the orders were received to identify the value of the orders for comparison to the $200,000 threshold in the Proposal. This would require broker-dealers to create systems to estimate the value of unpriced orders. Under the adopted rule, however, consistent with the Commission's analysis immediately above, broker-dealers would not incur such compliance costs because orders are currently identified as held or not held.

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[664] See supra notes 642 and 643.

2. Influence of De Minimis Exceptions on Compliance Costs

The Commission believes that the two de minimis exceptions to the adopted rule will further limit the scale of compliance costs on certain broker-dealers to provide Rule 606(b)(3) reports. Specifically, the Commission believes that adopted Rule 606(b)(4), which provides for a firm-level de minimis exception for broker-dealers, will limit the costs to broker-dealers that rarely handle not held NMS stock order flow. Absent a firm-level de minimis threshold, every broker-dealer that handles not held orders, regardless of its customer base and core business, would be subjected to compliance costs to create the systems and processes to generate and deliver the Rule 606(b)(3) reports. The supplemental staff analysis found that among the 342 broker-dealers that receive not held orders from customers in the sample data, about 8% (28 broker-dealers) would qualify for the firm-level de minimis exception from Rule 606(b)(3)'s requirements. Accordingly, the firm-level de minimis exception in Rule 606(b)(4) would result in approximately 8% of broker-dealers not incurring the compliance costs associated with the standardized customer-specific order handling reports required by Rule 606(b)(3). As discussed in Section V.C.1.a.i.2., the number of orders that will be excluded under the de minimis exception would be minimal compared to the current reporting requirement and to the proposal. The minimal amount of not held orders excluded under the firm-level de minimis exception suggests that there would be only limited benefits of Rule 606(b)(3) in circumstances where broker-dealers handle a minimal amount of not held orders, and that the resulting benefits of customer-specific order handling disclosures required by Rule 606(b)(3) may not be as great as intended.

The Commission also believes that the adopted approach of including a de minimis exception at the customer-level under the adopted Rule 606(b)(5) will also limit the compliance costs of broker-dealers associated with the new customer-specific order handling disclosures

under Rule 606(b)(3). This exception, therefore, could reduce compliance costs for broker-dealers of processing orders to produce and to deliver Rule 606(b)(3) reports for numerous customers that do not actively place not held orders.

The Commission also believes that the three-month grace period included in the firm-level de minimis exception could further limit the scale of compliance costs of broker-dealers. As discussed in Section III.A.1.b.iv., Rule 606(b)(4) allows broker-dealers to have a grace period of up to three calendar months to provide the new customer-specific disclosures the first time a broker-dealer meets or exceeds the 5% de minimis threshold. The adoption of the grace period will provide time for broker-dealers to create the systems necessary to prepare the 606(b)(3) reports, which could allow the broker-dealers to manage their implementation and ongoing compliance costs. In addition, once the broker-dealers set up the system to comply with the rule during the grace period, the broker-dealers could use the system in the future, which could help reduce the on-going reporting costs in preparing additional Rule 606(b)(3) reports.

The Commission acknowledges that the two de minimis exceptions may create uncertainty as to whether a customer would have access to the Rule 606(b)(3) report and as to whether a broker-dealer would be required to produce Rule 606(b)(3) reports on request. The staff's supplemental analysis found that a small number of broker-dealers fell slightly outside the 5% de minimis threshold during a recent sample period.[665] Specifically, eight broker-dealers receive not held orders greater or equal to 5% and less than 10% of the total shares of their orders in the sample. These broker-dealers would not qualify for the firm-level de minimis exception despite not predominantly receiving not held orders, and thus would not be excepted from preparing Rule 606(b)(3) reports for not held orders under the adopted rule. Additionally,

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[665] See supra notes 642 and 643.

the staff analysis found that five broker-dealers that meet the de minimis exception receive not held orders greater or equal to 2.5% and less than 5% of the total shares of their orders in the sample. These results indicate that the threshold for the firm-level de minimis exception could create uncertainty for broker-dealers as to whether they might receive enough not held orders to qualify for the de minimis exception and for how long they would qualify for the de minimis exception. However, the Commission believes that the firm-level de minimis exception under Rule 606(b)(4) could mitigate the uncertainty that is discussed above. As discussed in Section V.C.1.a.i.2., a supplemental staff analysis found that 23 broker-dealers that meet the de minimis exception receive not held orders less than 2.5% of the total shares of their orders in the sample, and among these broker-dealers the largest ratio of not held orders as percentage of total shares is less than 2.2%, which indicates that there is less concern of uncertainty regarding whether they meet the firm-level de minimis exception. Moreover, as discussed in Section III.A.1.b.iv., Rule 606(b)(4) requires that once a broker-dealer has equaled or exceeded the firm-level threshold based on its not held NMS stock order flow during a given six calendar month period, it must provide reports pursuant to Rule 606(b)(3) for at least the next six calendar months regardless of the nature of its order flow during the Compliance Period. Additionally, as discussed in Section III.A.1.b.iv., if, at any time after the end of a Compliance Period, the broker-dealer's not held NMS stock order flow falls below the 5% threshold for the prior six calendar months, the broker-dealer is not required to provide reports pursuant to Rule 606(b)(3), except with respect to orders received during the Compliance Period. These features of the firm-level de minimis exception under Rule 606(b)(4) could mitigate the uncertainty as to whether a broker-dealer would be required to produce Rule 606(b)(3) reports on request for the next six calendar months after the calendar month the broker-dealer exceeded this 5% threshold.

Further, as discussed above, the Commission acknowledges that the customer-level de minimis exception under Rule 606(b)(5) may result in certain customers with seasonality in their trading volume exceeding the threshold during certain months and not during others. As discussed above, to the extent that such customers receive net benefits from receiving new customer-specific reports under the requirement of Rule 606(b)(3) and that such customers have flexibility in their trading activities,[666] customers could be willing to incur the costs to alter trading behavior to receive the Rule 606(b)(3) reports more frequently during the year. Because customers' trading activity can be affected by future market conditions or unexpected events in the financial markets, it could be difficult for customers to predict at the time they are placing an order, whether that order could be in the standardized customer-specific reports.

3. Other Costs

The Commission also acknowledges that the firm-level de minimis exception in adopted Rule 606(b)(4) could incentivize broker-dealers to keep their not held trading volume below the 5% threshold. As discussed above, there are a small number of broker-dealers with not held orders slightly below or above the 5% de minimis threshold. Specifically, according to Table 1, for 8 broker-dealers, not held orders account for between 5% and 10% of orders received by that broker-dealer. To avoid the compliance costs, broker-dealers could discourage customers from using not held orders so as not to exceed the 5% threshold and therefore not to be subject to the obligations of providing the new disclosures upon request. Under this scenario, customers sending not held orders to these broker-dealers may not receive the benefit of the disclosure of

666 The Commission believes index funds time their trades to minimize tracking error. These institutions are concerned even about how when they trade within a trading day affects their tracking error. These institutions are unlikely to delay trading by a month just to qualify to receive a report for one additional inactive month.

customer-specific order handling practices required by Rule 606(b)(3) and could face additional execution costs if they suboptimally submit held orders relative to today. However, the Commission notes that for business reasons, some firms might choose to provide the new customer-specific order handling disclosures to its customers, regardless of the de minimis exception, limiting the costs of such incentives on investors. Further, customers that value the Rule 606(b)(3) reports could be willing to incur the cost of switching to the broker-dealers that do not receive or use the firm-level exception in order to ensure receipt of the customer-specific reports. As a result, the threat of losing customers could dampen the broker-dealers' incentives to encourage their customers to use held orders.

The Commission also acknowledges that the customer-level de minimis threshold under Rule 606(b)(5) could result in changes in customers' behavior, including an increase in not held orders over held orders or a consolidation of the customer's not held order flow with one broker-dealer in order to exceed the customer-level threshold to be entitled to receive such reports, which could be less optimal for customers relative to today. As discussed above, a broker-dealer will not be obligated to provide the new Rule 606(b)(3) order handling disclosures to any customer that trades on average each month for the prior six months less than $1,000,000 of notional value of not held orders through the broker-dealer. Therefore, a customer that submits more than $1,000,000 of notional value each month, but not in not held orders or at a single broker-dealer, could qualify for the Rule 606(b)(3) reports by instructing brokers to handle more orders as not held and/or by consolidating its order submission with fewer broker-dealers. However, some firms may choose to provide the new customer-specific order handling disclosures to its customers, regardless of the de minimis exceptions for business reasons, and the expectation of these reports could mitigate customers' incentives.

b. Customer Requests for Information on Customer-Specific Handling Under Adopting Rule 606(b)(3)

i. Benefits

The required customer-specific order handling disclosures being adopted under Rule 606(b)(3) will provide transparency about order routing and execution quality for not held orders placed by customers.[667]

1. Execution Quality Benefits

The Commission believes that Rule 606(b)(3) will benefit customers, because broker-dealers will have an additional incentive to improve their order routing decisions for customers submitting orders on a not held basis, who could also use the reports required by the amendments to Rule 606 to compare routing and execution quality among broker-dealers, which could lead to better execution quality for not held orders. As a result, Rule 606(b)(3), as adopted, could lead to more transparent order routing practices and execution quality disclosures, which could enhance competition in the market for brokerage services. The disclosures in Rule 606(b)(3) will provide customers that submit not held orders, including investment fund managers, standardized information regarding their broker-dealers' order routing practices and execution quality. To the extent that the reports required by Rule 606(b)(3) increase the transparency of order routing and execution quality for customers' not held orders, broker-dealers will be better able to compete along the execution quality dimensions provided in the reports, such as the fill rate, percentage of shares executed at the midpoint and priced at the near or far side of the quote, and average time between order entry and execution or cancellation for orders posted to the limit order book, in addition to commissions and other considerations on which they currently compete.

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667 See supra at Section 0.0.0.0.0.

The Commission believes that amended Rule 606(b)(3) could affect competition between trading centers. Broker-dealers routing more orders to the trading centers that are more beneficial for their customers could further promote competition between trading centers and promote innovation on execution quality. To illustrate, if broker-dealers change their order routing decisions to focus more on execution quality and route fewer orders to a given trading center, that trading center will have an incentive to take measures to attract and gain back order flow by innovating on execution quality. In addition to comparing broker-dealers on the basis of the reports, the amended Rule 606(b)(3) could facilitate and inform customer dialogues with their broker-dealers about the broker-dealers' order routing practices to better match the needs of the customers with the order routing practices of the broker-dealers to whom they send orders. As a result, as several commenters stated, the information on execution quality could better enable customers placing orders on a not held basis to evaluate the impact that routing decisions have on the quality of their order executions and could provide information regarding broker-dealers' potential conflicts of interest.[668] The Commission believes that the amended Rule 606(b)(3) will promote better order handling practices among broker-dealers, therefore potentially promoting competition between trading centers and ultimately incentivizing broker-dealers to improve execution quality of not held orders.

2. Benefits of Enhanced, Standardized Report

As adopted, Rule 606(b)(3) will address the concerns that current customer reports are not standardized. As discussed in the Proposing Release,[669] some customers currently request and receive reports about order routing and execution quality of their orders from their broker-

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668 See, e.g., Capital Group Letter at 3 and 6; STA Letter at 4; FSR Letter at 4-5; HMA Letter at 10; ICI Letter at 9; Schwab Letter at 2; Markit Letter at 9-10; Better Markets Letter at 5-8.

669 See Proposing Release, supra note 1, at 49437.

dealers. However, these reports are not standardized and, as a result, it may be difficult to compare broker-dealers on the basis of those reports. In addition, the availability, detail, and quality of such reports likely differ across customers, e.g., it might be the case that customers placing a greater volume of not held orders have easier access to such reports compared to customers with a smaller volume of not held orders. Moreover, the information provided by a broker-dealer may vary over time without any standardized or required content for the reports. As adopted, Rule 606(b)(3) could address both of these concerns as the reports will be standardized for all broker-dealers and all customers placing not held orders (subject to two de minimis exceptions) making comparisons easier and analysis more useful. Furthermore, every customer placing orders on a not held basis will be able to receive reports upon request from their broker-dealer.

The Commission believes that the benefits of the reports required by Rule 606(b)(3) may be modest for some customers that already receive reports from their broker-dealers on the handling of their not held orders, depending on the information such customers currently receive and how standardized that information is across broker-dealers. For example, the reports that a particular customer already receives may be more detailed and tailored to that customer. The Commission recognizes that some current ad hoc reports also may provide additional, more detailed, and/or more tailored information than what Rule 606(b)(3) requires. Customers receiving such enhanced reports may not benefit significantly from the information specified in Rule 606(b)(3). Nevertheless, the Rule 606(b)(3) requirement that the disclosures be standardized may allow these customers to more readily compare their broker-dealers, particularly if their broker-dealers currently provide disparate responses to similar requests.

The Commission believes that Rule 606(b)(3) will enable customers to better compare broker-dealers' order handling practices, which will allow customers to more efficiently monitor, evaluate, and select broker-dealers. Under Rule 606(b)(3), customers can obtain detailed information on the broker-dealer internalization rate and payment for order flow received. Currently, broker-dealers may prefer to internalize uninformed order flow.[670] Under Rule 606(b)(3) a customer will have information on whether its order flow is being internalized and could use this information in its relationships with its broker-dealers. Similarly, a customer will be able to monitor whether broker-dealers route orders to the trading center offering highest rebate or lowest fees.[671] Customers might be concerned if orders routed to a high-rebate destination do not execute or do so with a delay, as information about the order may leak into the market, thereby inducing price impact. Rule 606(b)(3) could mitigate such concerns.

As adopted, Rule 606(b)(3) requires the inclusion of actionable IOIs in customer-specific order handling disclosures. As adopted, Rule 600(b)(1) defines an actionable IOI as "any indication of interest that explicitly or implicitly conveys all of the following information with respect to any order available at the venue sending the indication of interest: (1) symbol; (2) side (buy or sell); (3) a price that is equal to or better than the national best bid for buy orders and the national best offer for sell orders; and (4) a size that is at least equal to one round lot." The Commission believes that the inclusion of actionable IOIs in the adopted reporting requirements of broker-dealers should provide customers a more complete picture of how their not held orders are handled. Since actionable IOIs can convey information similar to that of an order, a response

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670 See Hitesh Mittal, Are You Playing in a Toxic Dark Pool? A Guide to Preventing Information Leakage, 3 Journal of Trading 20 (Summer 2008).

671 A broker-dealer may take into account rebates when setting its flat-rate commission by asking for a lower commission. As long as the rebates are not passed through to the customer, however, the broker-dealer still has the incentive to maximize rebate capture.

to an actionable IOI may result in an execution at the venue of the IOI sender and thus can represent a portion of the liquidity available at a given price and time. The Commission therefore believes that actionable IOIs should be included in the required disclosure of how not held orders are handled. In addition, because an actionable IOI can convey information similar to that of an order, the use of actionable IOIs may contribute to information leakage in a way similar to that of the use of orders.[672] Specifically, the Commission believes that such information will enable customers in assessing whether their broker-dealers are exposing their not held orders to the select market participants with which the broker-dealer has affiliations or business relationships or from which the broker-dealer receives other incentives. In addition, the Commission believes that disclosure of this information will provide the customer with a more complete understanding of the broker-dealer's order handling activities for purposes of assessing the broker-dealer's execution quality generally. Excluding actionable IOIs, therefore, will not provide a complete picture of order routing and executions of a customer's not held orders and could provide broker-dealers with an incentive to use actionable IOIs instead of orders to circumvent the adopted disclosure requirements in Rule 606.

The Commission considered whether adopting a definition of actionable IOI in Rule 600(b)(1) may limit its potential benefits. Specifically, the adopted definition is substantively similar to the description of actionable IOI in the Regulation of Non-Public Trading Interest Proposing Release. Comments received on the Regulation of Non-Public Trading Interest Proposing Release indicated that some commenters were concerned that the discussion of actionable IOIs in that release was too stringent.[673] If the definition of actionable IOI is, in fact,

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672 See Proposing Release, supra note 1, at 49486.

673 Comments on the Regulation of Non-Public Trading Interest Proposing Release are available at http://www.sec.gov/comments/s7-27-09/s72709.shtml. Comments on actionable IOIs can be found in the

too narrow, then some IOIs will not be included in the definition of actionable IOI and will not be captured by the required reports on handling of not held orders. Consequently, it is possible that customers placing orders on a not held basis might find the reports to be less informative on order handling than if the definition of actionable IOIs was broader. This suggests that defining actionable IOIs too narrowly may limit the benefits of the adopted amendments. However, as discussed in Section III.A.2., the Commission's purpose here is improving the usefulness of the order handling and routing information conveyed by broker-dealers to their customers placing orders on a not held basis, and thus the definition of actionable IOI being adopted is appropriately tailored to serve the purpose of this rulemaking, minimizing the concern of limiting the benefits of the amendments.

Several commenters stated that the proposed definition for actionable IOIs is unclear, specifically as to whether the definition of actionable IOI excludes conditional orders.[674] The inclusion of conditional orders in the Rule 606(b)(3) report could have benefits because broker-dealers would include additional information in the Rule 606(b)(3) reports, which therefore could increase the benefits resulting from increased transparency. However, as discussed in Section III.A.2., many market participants distinguish conditional orders from actionable IOIs, because conditional orders are not firm representations of trading interest and may require additional negotiation before a trade can be executed. Therefore, the Commission acknowledges that the inclusion of conditional orders in the definition of actionable IOI may cause confusion in

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following letters: http://www.sec.gov/comments/s7-27-09/s72709-46.pdf and http://www.sec.gov/comments/s7-27-09/s72709-48.pdf.

674 See BIDS Letter at 4-5; Bloomberg Letter at 3-4; Capital Group Letter at 3; FIF Letter at 7; Markit Letter at 11-12; NYSE Letter at 2; SIFMA Letter at 6.

producing and consuming order handling reports, which could limit the benefits of Rule 606(b)(3) reports.

The Commission is adopting a modification to Rule 606(b)(3) that requires broker-dealers to disclose the fact that actionable IOIs were sent to customers placing not held orders but not the identity of such customers. The Commission believes that such modification should help ensure that customers receive detailed information in their report, while protecting the identity of institutions providing liquidity. The Commission believes that disclosing the specific venue or venues to which a broker-dealer exposed a not held order by an actionable IOI will be useful for the customer to further assess the extent of information leakage of their orders and potential conflicts of interest facing their broker-dealers. Specifically, the Commission believes that such information will enable customers to assess whether their broker-dealers are exposing their not held orders to the select market participants with which the broker-dealer has affiliations or business relationships or from which the broker-dealer receives other incentives. In addition, the Commission believes that disclosure of this information will provide the customer with a more complete understanding of the broker-dealer's order handling activities for purposes of assessing the broker-dealer's execution quality generally. Under the proposed Rule 606(b)(3), the Commission believed that requiring broker-dealers to identify the institutions to which they routed actionable IOIs would allow customers to receive additional details in their reports so that customers could better compare their broker-dealers. Regarding the requirement that broker-dealers identify the institutions to which they routed actionable IOIs, commenters expressed concerns that such identification may discourage institutions from providing liquidity if they do not wish their names to be disclosed to protect their proprietary information.[675] The

[675] See STA Letter II at 3; FIF Letter at 7; Fidelity Letter at 4; Markit Letter at 11.

Commission acknowledges that such identification may discourage such institutions from providing liquidity or induce broker-dealers to compromise the identity of their customers placing not held orders, which could reduce the benefits of disclosing actionable IOIs in the customer-specific reports. Thus, the modification to Rule 606(b)(3), as adopted, should help reduce the potential for information leakage and conflicts of interest between broker-dealers and their customers placing not held orders without discouraging institutions to provide liquidity.

The Commission also recognizes that, relative to proposed Rule 606(b)(3), this modification could result in customers receiving fewer details in their reports. While customers could have used such details to better compare their broker-dealers, the Commission does not believe that the identities of particular customers placing not held orders would significantly influence customers' decisions. Therefore, this modification does not significantly reduce benefits compared to the Proposal.

3. Additional Benefits

An additional benefit of Rule 606(b)(3), and specifically the benefit of having the standardized customer-specific order handling information available upon request, is that customers placing orders on a not held basis could combine the order handling information with existing TCA or enhance their TCA. As noted above, customers sending not held orders often work with independent third-party vendors to perform TCA as a means of evaluating the cost and quality of brokerage services. Customers sending not held orders can also conduct their own TCA in-house. TCA, whether conducted in-house or by a third-party, generally analyzes data on the parent orders, but typically cannot analyze data on the child orders because of the lack of

standardization of the current ad hoc order handling information. As a consequence, existing TCA typically does not incorporate information on how many child orders exist, a broker-dealer's order routing strategy of not held orders, or cost, routing, and execution quality for individual child orders. The disclosures required by adopted Rule 606(b)(3) will close this informational gap, so that customers will have more information on how broker-dealers handle and execute parent and child not held orders.

With this additional information, customers placing orders on a not held basis or their third-party vendors could combine the routing information with execution information to conduct a more thorough TCA than they can currently. In particular, the information in adopted Rule 606(b)(3) may be a factor that can explain transaction cost variations, and thus the reports from the adopted amendments could be combined with TCA to help explain differences in transaction costs and in performance as measured by TCA across broker-dealers. For example, TCA often includes transaction cost measures such as implementation shortfall, but adopted Rule 606(b)(3) will not.[676] With TCA alone, a customer may observe different implementation shortfalls across broker-dealers. The adopted amendments could allow the customers or their third-party vendors to correlate implementation shortfall with the routing decisions of the broker-dealers. This could assist the customers in assessing the execution quality provided by their broker-dealers. In summary, the Commission believes that Rule 606(b)(3) may complement and enhance all customers' evaluations of order handling quality of not held orders, including those of customers that use TCA.

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676 For example, Rule 606(b)(3) will not require reports to contain any information on implementation shortfall costs of parent orders, which are a key focus for investors placing not held orders. In general, the amendments, as adopted, are not intended to replace TCA and, therefore, do not include many metrics common to TCA. However, the Commission recognizes that the ability to use the adopting amendments to enhance TCA may make TCA more valuable and increase the incentives for customers to use TCA, either in-house or through a third-party vendor.

Rule 606(b)(3) also requires the customer-specific order handling report to be divided into separate sections for the customer's directed not held orders and non-directed not held orders, with each section containing the disclosures regarding the customer's order flow with the broker-dealer specified in Rule 606(b)(3), as well as the disclosures for each venue to which the broker-dealer routed not held orders specified in Rules 606(b)(3)(i) through (iv). Commenters suggested that directed not held orders be clearly segregated in the reports because this distinction could provide a more qualitative level of transparency and provide a more accurate description of broker-dealer's order routing practices, which could enable customers to better compare and monitor broker-dealers' order routing practices.[677] Specifically, commenters stated that to the extent that broker-dealers have more discretion on routing non-directed orders, dividing reports into directed and non-directed orders could bring greater transparency to customers placing not held orders. The Commission believes that reporting separate order handling statistics for the directed and non-directed not held orders will provide more valuable information to customers than if the statistics combined these orders. In particular, this will allow customers to specifically observe how the broker-dealers exercise routing discretion, which should increase the benefits of order disclosure by better informing customers of potential leakage and conflicts of interest. By providing the order handling information separately for non-directed not held orders, the Rule 606(b)(3) report will provide a customer with a more precise reflection of how and where its broker-dealer is routing the customer's not held orders pursuant to the discretion it is afforded. Otherwise, with directed not held orders and non-directed not held orders commingled in the report, it would be more difficult for a customer to differentiate routing behavior for which its broker-dealer exercised discretion from routing

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677 See supra note 245.

behavior that the customer itself directed. Therefore, the Commission believes that customers also will benefit from being able to analyze Rule 606(b)(3) order handling disclosures that are specific to their directed orders.

The Rule 606(b)(3) reports also require the broker-dealer to disclose, among other things, information on not held order execution.[678] This information will be relevant to a customer assessing its broker-dealer's execution of its directed orders, including a customer interested in validating that its broker-dealer is routing its directed not held orders consistent with the customer's instructions. These enhanced disclosures will better enable customers to analyze not held order routing and execution quality provided by broker-dealers, which will allow customers to more efficiently monitor, evaluate, and select broker-dealers. In addition, customers and broker-dealers will be able to evaluate execution quality of not held orders on different trading centers more efficiently. Therefore, the Commission believes that customers will benefit from the enhanced transparency in Rule 606(b)(3) reports.

Finally, Rule 606(b)(1) and Rule 606(b)(3) will require reports to be made available using an XML schema and associated PDF renderer published on the Commission's website.[679] The benefits, as well as the costs associated with this requirement, are discussed in Section V.C.4.

ii. Costs

The required customer-specific order handling disclosures being adopted under Rule 606(b)(3) will require broker-dealers to provide, upon request, standardized reports on not held order handling, which include more detailed information on broker-dealers' order routing

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678 See supra Section 0.A.0.

679 See supra Section 0.A.0.0.

practices. These requirements will result in initial and ongoing compliance and reporting costs to broker-dealers. These costs are quantified in Section V.C.1.b.ii.3. Additionally, the customer-specific order handling disclosure requirement under Rule 606(b)(3) could alter the information content of the report if broker-dealers already provide more information than is required by the adopted amendment or broker-dealers try to disguise order routing behavior to avoid customers' monitoring.

1. The Potential for Less Information

As discussed above, some customers currently request reports about the handling of their not held orders from their broker-dealers and those reports may be less or more detailed and provide different, and potentially less or potentially more, information than Rule 606(b)(3) will require. If broker-dealers currently provide more detailed or additional information to customers, reporting requirements under Rule 606(b)(3) could impose a cost on such customers if the broker-dealers stop providing the more detailed or additional information and instead provide only the data required for customer-specific order handling by Rule 606(b)(3). The Commission believes that this scenario is not very likely because, following Rule 606(b)(3)'s implementation, customers could still request additional information or customized reports from their broker-dealers and broker-dealers are likely to satisfy such requests, to the extent they currently do, to retain their customers. As discussed above, the willingness of broker-dealers to provide such customized reports to customers and the level of detail in such a report might depend on the business relationship between the broker-dealer and the customer. Customers that send or may send a large number of orders to broker-dealers might be able to get customized reports that they can more easily compare than customers that send fewer orders; and those reports might be more detailed, compared to reports that customers that send fewer orders receive. While Rule 606(b)(3) reduces this discrepancy, in that all customers will be able to

request the standardized reports required by Rule 606(b)(3), the Commission recognizes that, to the extent large customers placing orders on a not held basis are able to receive customized reports that provide information not contained in the required reports, those large customers placing not held orders will continue to have an advantage over smaller customers placing not held orders who are not able to receive the same reports.

2. Skewed Routing Practices

In addition, the greater transparency provided as a result of Rule 606(b)(3) might lead broker-dealers to change how they handle not held orders. Given that broker-dealers will be aware of the metrics to be used a priori, they might route not held orders in a manner that promotes a positive reflection on their respective services but that may be suboptimal for their customers. Any changes to broker-dealers' order routing decisions resulting from the Commission's adoption of Rule 606(b)(3) may be intended to benefit customers placing not held orders, but if broker-dealers and customers focus exclusively on the metrics in the reports required by Rule 606(b)(3), the order routing decisions could also be viewed as suboptimal for some customers.

For example, if a broker-dealer routes not held orders so that the orders execute at lower cost with a higher fill rate, shorter duration, and more price improvement than the broker-dealer's competitors, in order to achieve these objectives she might route the majority of non-marketable limit order shares to the trading center offering the highest rebate. A customer placing not held orders that reviews the order handling report might suspect that the broker-dealer acted in its self-interest by selecting the highest rebate venue in order to maximize rebates when, in fact, the broker-dealer made the decision on the basis of other variables, which might not be completely reflected in the amended reports. Under the amendments to Rule 606, the broker-dealer may be concerned about the perception of acting on a conflict of interest, when the

broker-dealer is in fact acting in the customers' interests. As a result, a broker-dealer may be incentivized to route fewer non- marketable limit order shares to the trading center offering the highest rebate, even if this imposes additional costs on the broker-dealer's customers, in an effort to ensure that a customer does not misconstrue the intent behind the broker-dealer's routing decisions. Such a potential outcome could reduce the intensity of competition between broker-dealers on the dimension of execution quality.

3. Compliance Costs

The disclosure requirements of Rule 606(b)(3) will also impose compliance costs, as the required disclosures could entail some reprogramming by broker-dealers that execute or route orders subject to the customer-specific disclosures required by Rule 606(b)(3). A broker-dealer would have to program its systems to filter their order data by a condition using a held or a not held indicator, subject to two de minimis exceptions. In addition to reprogramming, receiving and processing customer requests, as well as preparing and transmitting the data to customers on request, will impose costs.

The Commission estimates and discusses compliance burdens and costs for broker-dealers that routes orders subject to the customer-specific disclosures required by Rule 606(b)(3) in Section IV.D.1.ii. The Commission estimates total initial implementation costs for all broker-dealers that route orders subject to the customer-specific order handling disclosures required by Rule 606(b)(3) and that do not currently retain order handling information required by the adopted rule to program systems to comply with the adopted rule change is 24,070 hours, resulting in a monetized total cost burden of $7,789,300.[680] In addition these broker-dealers

[680] See supra note 510.

would incur an additional cost of $5,660,000[681] to engage the third-party service providers and to purchase hardware and software upgrades.

The Commission estimates and discusses compliance burdens and costs for broker-dealers responding to a Rule 606(b)(3) request (for broker-dealers that handle their own responses) in Section IV.D.1.b. The total annual cost for all 200 broker-dealers that route orders subject to the customer-specific order handling disclosures required by Rule 606(b)(3) to comply with the customer response requirement in Rule 606(b)(3) is estimated to be 67,000 hours, resulting in a cost of $14,928,000, plus an additional fee of $1,300,000 to compensate third-party service providers for producing the reports.[682] The Commission recognizes that the hours and costs that it has estimated could be lower if this report function is outsourced to a third-party to the extent that a third-party is specialized in preparing the order handling reports and has a system in place. In particular, economies of scale could help lower the costs incurred by third-parties relative to the broker-dealers themselves, and, therefore, the third parties could charge some broker-dealers less to produce the reports than the broker-dealers would incur to produce the reports themselves.

As discussed in Section III.A.6, Rule 606(b)(3) requires the inclusion of actionable IOIs in the reports on order handling that broker-dealers will provide to their customers. The Commission expects that broker-dealers will incur costs from the inclusion of actionable IOIs in the reports as a result of having to process data and run calculations related to actionable IOIs. The estimated cost of including actionable IOIs in the customer-specific order handling reports

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681 See id.

682 See supra notes 525.

required by Rule 606(b)(3) is included in the aggregate costs described in the discussion above and in greater detail in Section IV.D.1.

Additionally, as noted above, adopted Rule 606(b)(3) requires segregated reporting of directed not held orders and non-directed not held orders. The Commission expects that broker-dealers will incur costs from separately reporting directed and non-directed not held orders as a result of having to process additional data and run additional calculations. The estimated cost of separate reporting is included in the aggregate costs described in the discussion below and in greater detail in Section IV.D.1.

As discussed above, Rule 606(b)(1), as amended, does not modify any of the current customer-specific disclosure requirements but modifies the categories of orders to which the disclosure applies. Current Rule 606(b)(1) applies to all customer orders, i.e., orders having a market value of less than $200,000. However, broker-dealers must now modify their systems to provide the disclosures for the following types of orders, regardless of market value: (i) orders in NMS stocks that are submitted on a held basis; (ii) orders in NMS stocks that are submitted on a not held basis and are excepted from the disclosure requirements of Rule 606(b)(3); or (iii) orders in NMS securities that are option contracts.

The Commission believes that it is reasonable to estimate that one third of the 292 broker-dealers that route orders subject to the disclosures required by Rule 606(b)(1) – 97 broker-dealers – will implement these changes in-house, while the remaining number – 195 broker-dealers – will engage a third-party vendor to do so.[683] The Commission estimates the initial burden for a broker-dealer that will program its systems in-house to comply with Rule

[683] See supra note 560.

606(b)(1) as 24 hours.[684] The Commission estimates the initial burden for a broker-dealer that will engage a third-party vendor to program its systems to comply with the rule as 3 hours and $979.[685]

Therefore Commission estimates the total initial burden for all 292 broker-dealers to program their systems to comply with Rule 606(b)(1) as 2,913 hours[686] and $975,000.[687]

4. Other Potential Costs

Further, as a result of adopting Rule 606(b)(3), broker-dealers that route not held NMS stock orders will likely reevaluate their best execution methodologies to take into account the availability of new statistics and other information that may be relevant to their decision making. This may impose a cost only to the extent that broker-dealers choose to build the required statistics into their best execution methodologies. In addition, they may choose to do so only if the benefits justify the costs.

Another potential cost of adopted Rule 606(b)(3) is that the reports could be viewed as a replacement of TCA and therefore have a negative impact on the market for TCA. Specifying a minimum length of time for making the Rule 606 reports publicly available may further impose a cost on third-party vendors that plan to aggregate the time series of the reports. For example, suppose that a customer chooses to no longer purchase TCA once Rule 606(b)(3) reports become available, because the customer decides that the information contained in the Rule 606(b)(3) reports is sufficient. If fewer customers purchase TCA, it will have a negative impact on third-party providers of TCA as well as third-party data vendors, because of a reduction in the demand

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684 See supra note 578.

685 See supra note 579.

686 See supra note 581.

687 See supra note 582.

for their services, for example. Further, the quality of TCA provided by third-parties may decrease because third-party providers of TCA might have fewer resources for the development and maintenance of their product offerings and because fewer customers would reduce the amount of data that the third-party providers would use to build their models.[688] However, as discussed in Section V.C.1.b.i, the reports required by adopting Rule 606(b)(3) will provide information that could be complementary to TCA. As discussed above, in fact, adopted Rule 606(b)(3) could make TCA more useful and provide incentives for customers to use TCA. As a result, the Commission believes that adopted Rule 606(b)(3) will not replace TCA.

The Commission considered whether the customer-specific order handling reports of adopted Rule 606(b)(3) could impose costs on broker-dealers by revealing sensitive, proprietary information about broker-dealers' order handling techniques. Rule 606(b)(3) does not require public disclosure, so the Commission believes that there would be minimal risk of information leakage to the public. Moreover, as some commenters stated, to the extent that the customer-specific order handling disclosures will aggregate information to be disclosed across all of the customer's not held NMS stock orders, the information leakage risk is low because reverse engineering specific order routing strategies from such aggregated data would be extremely difficult.[689]

To the extent it is likely for customers choose to make the disclosure public, order routing practices of not held NMS stock orders of the customers' broker-dealers could become available publicly, which other customers placing not held NMS stock orders could use in

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688 As stated in the proposing release, the Commission understands that customers of third-party TCA providers typically transmit their execution data to their TCA providers. The third-party TCA providers in turn base their models on the data they receive from all their customers. Having more data to base models on is generally beneficial and may result in better models.

689 See Capital Group Letter at 5; Markit Letter at 19.

comparing their broker-dealers' order routing. To the extent that the order routing reports could reveal sensitive, proprietary information about broker-dealers' order handling techniques, the broker-dealers' trading strategies could be used by their competitors, specifically, putting smaller broker-dealers at a competitive disadvantage relative to larger broker-dealers, as the majority of their trading strategies could more easily be revealed to other market participants. However, because the customer-specific order handling disclosure required by Rule 606(b)(3) could reveal highly sensitive proprietary information about the revealing customers' trading strategy, it is unlikely that customers would make their own reports public. In addition, even if the customer did share its report, the fact that the information in it is aggregated obscures the broker-dealer's order handling decision for any particular order. Therefore, the Commission believes the risk that the customer-specific order handling disclosure required by Rule 606(b)(3) would reveal sensitive, proprietary information about broker-dealers' order handling techniques would be minimal.

2. Public Order Handling Report

Rule 606(a) requires each broker-dealer to make publicly available quarterly reports on its routing of non-directed orders in NMS securities.[690] The Commission believes that the amendments to Rule 606(a), as adopted, will increase the level of transparency about order routing and execution quality for non-directed orders in NMS stocks that are submitted on a held basis through the enhanced disclosure of data regarding order routing and execution.[691]

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690 The Commission had proposed, but is not adopting, a similar requirement for broker-dealers to provide public quarterly reports broken down by calendar month on the order routing and execution quality of institutional orders by each broker-dealer. See infra Section 0.0.0 for an analysis of the proposed amendments for institutional orders that the Commission is not adopting.

691 See supra Section 0.0. and Adopted Rule 606(a)(1)(iv).

The benefits and costs of each of these amendments are discussed below. Wherever possible, we quantify cost estimates for a given amendment. For the remaining amendments concerning non-directed orders in NMS stocks that are submitted on a held basis, we provide total quantitative cost estimates for these amendments in Section V.C.2.f.

a. Orders Subject to Rule 606(a) Public Disclosures

i. Benefits

As adopted, Rule 606(a) applies to NMS stock orders of any size that are submitted on a held basis. Rule 606(a) also continues to apply to any order (whether held or not held) for an NMS security that is an option contract with a market value less than $50,000, as the Commission did not propose, and is not adopting, any modifications to Rule 606's coverage of option orders.[692] Specifically, Rule 606(a)(1), as amended, states that every broker-dealer must make publicly available for each calendar quarter a report on its routing of non-directed orders in NMS stocks that are submitted on a held basis and in non-directed orders that are customer orders in NMS securities that are option contracts during that quarter broker down by calendar month. As noted above,[693] the Commission is adopting a modified definition of the term "non-directed order" that no longer includes a dollar-value limitation on NMS stock orders,[694] but continues to exclude orders from a broker-dealer.[695]

Under the scope of public order handling reports prior to these amendments, held orders with market value of at least $200,000 were not included in public order routing reports and broker-dealers may voluntarily provide some information on routing and execution quality in

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692 See supra notes 37 and 38.

693 See supra Section 0.A.0.0.0.

694 See Rule 600(b)(49). Consistent with this modification, Rule 606(a)(1)(i) also is revised to no longer refer to the defined term "customer order."

695 See supra Section 0.A.0.0.

response to requests by these customers that submit such orders. Because the amended rule requires public order routing reports for held orders of all sizes, these orders will be included in the public order routing reports. In addition, pursuant to Rule 606(b)(1), customers sending held orders of at least $200,000 in market value will continue to receive the same information from the pre-existing customer-specific order routing disclosure rule.

The staff's supplemental analysis found that more than 80% of shares and more than 88% of orders received from individual accounts[696] are held orders, suggesting that the amended Rule 606(a) would provide public order routing disclosure for the types of orders that retail investors are more likely to use, which would make the public reports more relevant to these investors. The staff analysis also found that among the orders of less than $200,000, about 55% of total shares and about 67% of number of the orders in the sample are held orders. The analysis indicates that the public order routing reports prior to these amendments are likely to reflect not held orders in addition to held orders, and therefore, the amendments would result in public order routing reports better reflecting held orders but lessen the relevance of the reports for not held orders. The staff analysis also showed that about 10% of total shares and about 0.4% of total numbers of orders in the sample are held orders with a market value of at least $200,000. These orders will receive public order routing reports under the amendment in addition to the disclosures required by Rule 606(b)(1).

The Commission believes that, compared to the scope of public order handling reports prior to the amendments, Rule 606(a)(1), as amended, could make the public order routing reports more informative and therefore could improve the value of the public order routing reports. To the extent that broker-dealers generally handle not held orders differently from held

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696 See supra notes 642 and 643.

orders, and to the extent that typically institutional customers use not held orders,[697] the information pertinent to understanding broker-dealers' order handling practices for not held orders is not the same as for held orders. Moreover, as discussed above, the staff analysis showed that orders received from institutional accounts are more likely to be not held orders than orders received from individual accounts, suggesting that the amended public reports would target customers distinct from institutional investors. As discussed in Section V.C.1.a.i, commenters suggested that the held and not held order type classifications would be effective proxies for distinguishing institutional investor orders and retail investor orders because retail investor orders are generally held to the market and institutional investor orders are generally not held to the market.[698] Moreover, as discussed in Section V.C.1.a.i, because broker-dealers have discretion on time and price for not held orders and do not on held orders, customers placing held orders would have a different level of sophistication than customers that typically place not held orders. In addition, to the extent that the previously existing public order routing reports were in aggregate forms and therefore the customer could not distinguish the order routing practices of held orders from not held orders, replacing public order routing reports with customer-specific reports for not held orders could provide different scopes of benefits of order routing disclosure to the customers. As previously discussed, customers sending not held orders may have a different preference on order routing and a different level of sophistication in understanding the price, time, and other discretion embedded in not held orders. As a result, the amended rule may better serve customers that do not require an understanding of the price, time, and other

697 See supra Section 0.A.1.b.ii.

698 See Ameritrade Letter at 2; BlackRock Letter at 2; Citadel Letter at 2-3; Markit Letter at 4; Schwab Letter at 3; Capital Group Letter at 2-3; KCG Letter at 4; FIF Letter at 2-3; FIF Addendum at 2; STA Letter II at 2. One commenter noted its belief that the vast majority of orders entered by institutional customers are with not-held instructions and the vast majority of orders entered by retail investors have held instructions. See STA Letter at 4.

discretion embedded in not held orders and therefore would allow these customers to better understand the reports and more efficiently monitor, evaluate, and select broker-dealers. Additionally, the amended 606(a) could provide more effective order routing reports for customers and inform customers of different scopes of disclosure that could address the extent of discretion that the broker-dealers exercise in order handling. Therefore, the Commission believes that relative to the baseline and the proposed definition of retail orders, the amendment to Rule 606(a) could make the public order routing reports more informative, and may better target the information needed by investors that typically use held orders, thus making available more useful public order routing reports to customers and increasing the benefits from improved public order routing reports. With more targeted information, the Commission believes that customers will be able to better compare and monitor broker-dealers' order routing practices, which will promote competition among broker-dealers and improve the benefits of public information on order routing of held orders.

The Commission believes that the amended rule will enhance benefits for customers sending held orders having a market value of at least $200,000 relative to the baseline and the proposed definition of retail orders. As discussed above, to the extent that the majority of orders from individual accounts are held orders, customers sending held orders of at least $200,000 will receive information from public order routing reports that better reflect held orders under the amended rule. Because the amended rule includes held orders of all sizes, the public order routing reports will include all relevant orders and therefore customers could use the reports to compare and monitor broker-dealers order routing practices. As a result, customers sending held orders of at least $200,000 could use the information from the public order routing reports in assessing broker-dealers' order routing practices, which could promote better execution quality

and competition among broker-dealers. In addition, from the disclosures set forth in Rule 606(b)(1), customers sending held orders of at least $200,000 in market value will continue to receive the same information from the pre-existing customer-specific order routing disclosure rule, in addition to the information from the public order routing reports.

ii. Costs

Amended Rule 606(a) will create compliance costs, as broker-dealers will need to distinguish held orders from all customer orders they receive and prepare public order routing reports regarding these held orders and prepare reports, subject to the de minimis exceptions in Rules 606(b)(4) and (b)(5). The related compliance costs are discussed in Section V.C.2.f. The costs related to Rules 606(b)(4) and (b)(5) are discussed in Section V.C.1.a.ii.

The Commission believes that the amended Rule 606(a) will result in implementation costs but might not create substantial ongoing costs for broker-dealers. As discussed in detail in Section V.C.1.a.i., broker-dealers' familiarity with held and not held orders would facilitate compliance with and may contain potential compliance costs imposed on broker-dealers because broker-dealer could use less processing time to identify held orders as compared to the proposed $200,000 threshold. The staff's supplemental analysis[699] found that among the sample orders of less than $200,000, about 55% of shares and 67% of number of orders are held orders, suggesting that these broker-dealers would be already engaged in public reporting of orders less than $200,000 and therefore would not need to develop entirely new systems for the public reports for held orders. The staff analysis also found that the total held orders that are newly included in the public order routing reports are about 10% of total shares and less than 0.5% of total number of orders in the sample of NMS stocks in the analysis, suggesting that the

[699] See supra notes 642 and 643.

implementation costs would not be significant for broker-dealers as a whole that newly need to prepare public order routing reports. Additionally, to the extent that broker-dealers would have a system in place to prepare the customer-specific reports under the scope of public order handling reports prior to these amendments, broker-dealers would need to modify their existing systems rather than build an entirely new system. Further, to the extent that broker-dealers would not need to identify the market value of orders, the amended rule could require fewer processing time for broker-dealers as compared to the proposed $200,000 threshold. Therefore, the Commission believes that the amended rule would not impose significant compliance costs to the broker-dealers as a whole to prepare the public order routing reports for held orders of all sizes.

The Commission also acknowledges that the amended rule will create additional compliance costs for broker-dealers that receive held orders of at least $200,000. As discussed above, under the amended rule, broker-dealers would need to prepare for the reports, subject to the de minimis exceptions in Rules 606(b)(4) and (b)(5), for all held orders, in addition to the public order routing reports. As previously discussed, the staff analysis showed that close to 23% of total shares and about 36% of total numbers of orders that are not included in the scope of public order handling reports prior to these amendments will be included under the amended rule subject to the de minimis exceptions set forth in Rules 606(b)(4) and (b)(5). The staff analysis also suggests that depending on the amount of held orders relative to total orders that broker-dealers receive, the compliance costs would vary across broker-dealers.[700] Although broker-dealers will incur cost in switching between pre-existing customer-specific order routing

[700] For example, based on the staff's supplemental analysis, when all of the orders broker-dealers receive are on a held basis, about 19% of total shares have a market value of at least $200,000. In addition, when the ratio of not held orders that broker-dealers receive from customers is greater than 50% and less than 100%, less than 4% of total shares of orders in the analysis are on a held basis and have a market value of at least $200,000.

reports and public order routing reports, the Commission believes that the amended rule may limit certain costs. For example, as the staff analysis found, when all of the orders broker-dealers receive are on a held basis, about 19% of total shares have a market value of at least $200,000 and the rest of 81% of total shares of orders in the sample data have a market value less than $200,000.

The Commission believes that the broker-dealers already have a system to produce public order routing reports and therefore may simply send the received orders of at least $200,000 to the system they use to generate public order routing reports without a creating a completely creating a new system to capture held order with a market value of at least $200,000. Furthermore, as discussed in Section V.C.1.a.i., because broker-dealers are already familiar with held and not held distinction, and broker-dealers already characterize on a held or not held basis to comply with Rule 605's covered order requirement and other rules such as FINRA Rule 5320, broker-dealers would not incur additional costs in distinguishing held orders from not held orders. Additionally, as the staff analysis indicates, to the extent that broker-dealers receiving orders of both at least $200,000 and less than $200,000 value would already have systems in place to prepare for the reports required by the previously existing, the amended rule would not create substantial costs to these broker-dealers that are subject to reporting requirement of both amended Rule 606(a) and 606(b)(1). Therefore, the Commission believes that the amended rule would not impose significant compliance costs to the broker-dealers that need to include held orders having a market value at least $200,000 to the public order routing reports.

The Commission also believes amended Rule 606(a) would not impose substantial costs on the customers whose orders would have been included in public order routing reports under the baseline and the proposed definition of retail orders but will not be included in the reports

under the amendment. The staff's supplemental analysis found that among the orders of less than $200,000 in market value, about 45% of total shares and about 33% of the total number of orders in the sample of 120 NMS stocks will not be included in aggregated public order routing reports under the adoption, whereas these orders would have been included in the public routing reports under the baseline and the proposed definition of retail orders. Thus, customers that send not held orders of less than $200,000 in market value would not receive the benefit from the enhanced order handling transparency provided in the public order routing reports under the amended Rule 606(a). Instead, the orders that were included in the public routing reports under the baseline and the proposed definition of retail orders and are not included under the amended rule are subject to Rule 606(b)(3) and therefore would be included in the customer-specific reports required by Rule 606(b)(3). As discussed above, customers placing not held orders likely have a different level of sophistication in understanding the price and time discretion embedded in not held orders. Moreover, the enhanced Rule 606(b)(3) reports will be very detailed and of more value to those likely to make special requests of their broker-dealers, such as those who use not held orders. As a result, under the amendment, customers placing not held orders of less than $200,000 in market value would receive reports that target their needs and sophistication. Moreover, as discussed above, to the extent that the amendment to Rule 606(a) could better target the public order routing to the needs of investors that typically use held orders, the amended would not affect customers typically placing not held orders. Therefore, even though a customer's not held orders are not included in the public routing reports, the customer would receive Rule 606(b)(3) reports and therefore would receive the benefit of increased transparency from the customer-specific order handling disclosure required by Rule 606(b)(3).

b. Marketable Limit Orders and Non-Marketable Limit Order

i. Benefits

The Commission believes that the amendments to Rule 606(a) that require broker-dealers to differentiate marketable and non-marketable limit orders will create an opportunity for more detailed analysis.

In particular, the amendments could allow the public, including customers placing orders subject to Rule 606(a)(1), to better understand the potential conflicts of interest broker-dealers face when routing such orders,[701] which could incentivize broker-dealers to better manage these and other potential conflicts of interest, which may result in improved order routing decisions and execution quality for orders.[702] In addition, if the amended disclosure results in broker-dealers improving their order routing for orders subject to Rule 606(a)(1), which, in turn, may change which trading centers the broker-dealers route such orders to, the amended disclosure could further promote competition among trading centers.[703] In addition, adopting this new disclosure may lead to innovation by existing trading centers and may attract new entrants and the formation of new trading centers.[704]

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701 Academic research has identified indications of such routing behavior for orders that retail investors typically use. On examining the order routing of 10 broker-dealers, the researchers find that 4 of the broker-dealers sell market orders to market makers and route limit orders to market makers or exchanges offering the largest liquidity rebates. In addition, their study indicates that a negative relation exists between take fees and the likelihood that a limit order fills and the speed and realized spread of the associated fill. For more details, see Battalio, Corwin, and Jennings Paper, supra note 368. See also Proposing Release, supra note 1, at 49492.

702 See Proposing Release, supra note 1, at 49492 and Transaction Fee Pilot Proposing Release, supra note 2, at 13310. Several commenters agreed that the separation of marketable and non-marketable limit orders in the Rule 606(a) disclosures could provide customers with more useful information they can use when assessing if and how well broker-dealers manage the potential conflicts of interest. See, e.g., CFA Letter at 4-5, 9; Fidelity Letter at 8-9; Ameritrade Letter at 3.

703 See Proposing Release, supra note 1, at 49492.

704 In particular, a trading center that loses order flow to venues that offer better execution quality will have the incentive to innovate to improve its execution quality. Therefore, because the amended disclosures may

ii. Costs

As adopted, the amendments to Rule 606(a) requiring broker-dealers to differentiate between marketable and non-marketable limit orders will impose costs on broker-dealers. Specifically, broker-dealers will incur new compliance and reporting costs if they do not currently break down marketable and non-marketable limit orders and will need to break out this information in their internal systems. The estimates for compliance costs are contained in the estimates for the costs of producing the reports discussed in Section V.C.2.f. One commenter indicated that the amendment will require broker-dealers to obtain a searchable, historical store of all NMS quotes to be integrated into the reporting system, so that marketability of orders can be determined.[705] The Commission believes that whether to use a historical store of quotes depends on how broker-dealers capture marketable and non-marketable limit orders as required by the public order handling reports prior to today's amendments. Some broker-dealers already have to break down marketable and non-marketable for Rule 605 reports. To do so, some of these broker-dealers capture quotes in real-time and some broker-dealers match orders up with quotes later. Only the latter approach requires setting up an historical store of quotes for broker-dealers and broker-dealers likely will select the system with lesser costs to them. The Commission expects that any broker-dealers that are not already separating marketable and non-marketable orders for Rule 605 reports, will also likely manage costs by selecting the system with lesser costs to them and, therefore, would not necessarily need to set up an historical store of quotes. The Commission estimated the costs associated specifically with implementation of

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encourage broker-dealers to route for better execution quality, they may lead to innovation on trading centers.

705 See Markit Letter at 33.

systems to allow the marketability of orders to be determined to comply with the requirement that the Rule 606(a)(1). The estimates for the costs of producing the reports discussed in Section IV.D.4.a.ii. contain the estimates for the compliance costs that consider the two most likely approaches discussed above.

c. Net Payment for Order Flow and Transaction Fees and Rebates by Specific Venue

i. Benefits

As discussed above in Section V.C.2.b.i., the information required by Rule 606(a)(1)(iii) could also allow the public, including customers placing orders covered by Rule 606(a)(1), to better understand the potential conflicts of interest broker-dealers face when routing such orders which could incentivize broker-dealers to better manage these and other potential conflicts of interest, which may result in improved order routing decisions and execution quality for orders.[706]

Under Rule 606(a)(1)(iii), customers and the public could use information on net payment for order flow, payment from any profit-sharing relationship received, transaction fees paid, and transaction rebates received per share and in total to gauge whether payments for order flow or maker-taker fees affect the order routing decisions of broker-dealers.[707] Brokerage commissions, which are known to the customer, may depend on the rebates and take fees collected or paid by broker-dealers.[708] For example, broker-dealers that collect more in rebates may pass this income on to customers by charging lower commissions. However, routing solely

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706 See Proposing Release, supra note 1, at 49438-40, for an example of routing decisions being affected by conflicts of interest.

707 See, e.g., Battalio, Corwin, and Jennings Paper, supra note 368.

708 The Commission does not believe that fees and rebates are the only determinants of brokerage commissions.

to maximize rebates or minimize take fees may result in lower execution quality than other routing strategies. Without the new disclosure requirements, customers might take only brokerage commissions into account and might, therefore, sub-optimally choose the lowest commission broker-dealer, without considering other relevant costs. Such customers could, in fact, end up paying higher net costs if the lower commission broker-dealers do not obtain good execution quality for the orders. The information required by adopted Rule 606(a)(1)(iii), together with the other adopted amendments to Rule 606(a), will give customers additional information to make decisions on the basis of more than the brokerage commissions.

In addition, as discussed in Section V.C.2.b.i., if broker-dealers improve their order routing for orders covered by Rule 606(a)(1), which may result in changes to which trading centers they route such orders to, it could promote competition between trading centers, leading to innovation or new entrants to the market. The trading centers may change their fees or attempt otherwise to attract such order flow, and the quarterly public reports that are broken down by calendar month will allow them to see effects of any changes they implement.

Commenters in general indicated that information on any payment for order flow, payment from any profit-sharing relationship received, the transaction fees paid, and transaction rebates in the report as required by Rule 606(a)(1) could allow customers to better assess their broker-dealers' order routing practices and provide additional incentives to broker-dealers to monitor the potential conflicts of interest.[709] As discussed above and in the Proposing Release, the Commission believes requiring broker-dealers to modify or provide additional information in the order routing reports will enhance the benefits of improved transparency.[710]

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[709] See, e.g., Better Markets at 3-5, 7; FSR Letter at 7; HMA Letter at 11; Schwab Letter at 2.

[710] See Proposing Release, supra note 1, at 49442-43.

Some commenters raised concerns that enhanced reporting requirements under Rule 606(a)(1)(iii) will generate extensive information and may undermine the Commission's transparency goals. Specifically, some commenters stated that the Commission's transparency goals may be limited because the disclosure presents too much information and could create more confusion than provide clarity to retail investors.[711] In addition, one commenter stated that the additional information may not help customers better evaluate broker-dealers and may not promote competition among broker-dealers unless investors are educated on the interpretation of the information on the reports.[712] The Commission continues to believe that retail customers will benefit from the increased transparency and information being made available under the new Rule 606(a)(1)(iii). The Commission believes that to the extent a customer does not understand these disclosures, the customer could ask their broker-dealer for a better explanation of the arrangement, which may help mitigate some commenters' concerns that transparency goals may be limited because of too much information. Additionally, to the extent retail investors would like more information regarding these disclosures, they could seek such information from all available resources.

ii. Costs

Adopted Rule 606(a)(1)(iii) will impose initial compliance costs on broker-dealers in creating a new process to complete the reports and increase ongoing costs related to incorporating additional information into the reports. The estimates for the compliance costs are contained in the estimates for the costs of producing the reports discussed in Section V.C.2.f.

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711 See Fidelity Letter at 5; STA Letter at 3.

712 See Harvan Letter.

In addition to compliance costs, amended Rule 606(a)(1)(iii) could result in costs to broker-dealers or investors, depending on how broker-dealers and investors adjust their behavior in response to the increased transparency. Increased transparency from adopted Rule 606(a)(1)(iii) about the net aggregate amount of any payment for order flow, payment from any profit-sharing relationship, transaction fees paid, and transaction rebates received, and subsequent scrutiny by customers – in particular retail customers, the public, academics, regulators, and the financial media, might lead broker-dealers to decrease the degree to which they internalize orders and route orders to high-rebate or low-fee exchanges to avoid the perception of conflicts of interest. Broker-dealers might do this if they perceive that the potential costs from increased public scrutiny resulting from the enhanced disclosures to be relatively high, compared to the benefit from sending such orders to internalizers or routing orders to high-rebate and low-fee trading centers. If this were to occur then these orders might be more likely to be routed to trading centers other than internalizers, such as exchanges or alternative trading systems,[713] regardless of potential execution quality differences such as relatively less price improvement, or they might be more likely to be routed to other lower rebate or higher fee venues, regardless of the potential execution quality differences. In addition, if broker-dealers were to reduce the order flow sent to internalizers who pay for it, the broker-dealers would receive less payment for such order flow and might pass the lost payments on to their customers by raising brokerage commissions or other fees. Similarly, if broker-dealers were to route such orders to trading centers with lower rebates and higher fees, they might pass the reduction in rebate revenue and increase in fee costs on to their customers by raising brokerage commissions or other fees.

[713] A "trading center" is defined in Rule 600 of Regulation NMS. See 17 CFR 242.600(b)(78).

Increased transparency Rule 606(a)(1)(iii) about net payment for order flow and payments from profit-sharing relationships, and subsequent scrutiny by customers, the public, academics, regulators, and the financial media, might also lead broker-dealers to alter their payment for order flow or profit-sharing relationships or not enter into such relationships. Broker-dealers might do this if they perceive the potential costs from increased public scrutiny to be relatively high compared to a broker-dealer's benefit from such relationships. This could lead to lower payments received from such relationships. The affected broker-dealers might offset these lower revenues or higher costs by increasing brokerage commissions or other fees for customers.

d. Discussion of Arrangement Terms with a Specified Venue

i. Benefits

The Commission believes that the additional information provided by Rule 606(a)(1)(iv) will help ensure consistent, accurate, and comprehensive disclosure of terms of payment for order flow and profit-sharing relationships that influence broker-dealer order routing decisions. This will make the public reports required by amended Rule 606(a) more useful to customers and the public, and the benefits of the description required by Rule 606(a)(1)(iv) are similar to the benefits of the disclosures of the net payment for order flow and transaction fees and rebates by Specified Venue required by Rule 606(a)(1)(iii) and discussed in Section V.C.2.c.i.

Consistent with the limit order disclosure discussion above,[714] the disclosures required by Rule 606(a)(1)(iv) could allow the public, including retail customers placing held NMS stock orders, to better understand the potential conflicts of interest broker-dealers face when routing

[714] See supra Section V.C.2.b.i.

such orders, incentivize broker-dealers to improve order routing, and promote competition in the market.[715]

The Commission agrees with comments that stated that the disclosure of any agreement that may influence a broker-dealer's routing decisions could be useful for customers to assess the potential conflicts of interest facing broker-dealers when implementing their order routing decisions and the enhanced disclosures provide more complete information for customers to better understand and evaluate a broker-dealer's order routing decision.[716] Therefore, the Commission believes that the disclosure requirements in Rule 606(a)(1)(iv) could motivate broker-dealers to improve execution quality of orders.

Some commenters indicated that voluminous information may limit the transparency benefits for customers because it may not be easy to find or use the information to assess and compare broker-dealers.[717] As discussed in Section V.C.2.c.i., the Commission believes that the requirements would provide information that would not be overly voluminous or difficult to comprehend for customers, in particular retail customers. Additionally, the requirements in Rule 606(a)(1)(iv) are already substantially improving transparency compared to the reporting practices prior to these amendments. Therefore, the Commission believes that the reporting requirement under the adopted Rule 606(a)(1)(iv), as adopted, will make the public reports required by amended Rule 606(a) more useful to customers and the public, and the benefits of the description required by Rule 606(a)(1)(iv) are similar to the benefits of the disclosures by Rule 606(a)(1)(iii) that are discussed in Section V.C.2.c.i.

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715 See Proposing Release, supra note 1, at 49438-40, for an example of routing decisions being affected by conflicts of interest.

716 See, e.g., Better Markets Letter at 4-6; CFA Letter at 9; Fidelity Letter at 7; HMA Letter at 11; Markit Letter at 31.

717 See, e.g., Fidelity Letter at 9; STA Letter at 3.

ii. Costs

The Commission recognizes that the amendments to Rule 606(a)(1)(iv) will impose initial and ongoing compliance costs on broker-dealers. As discussed in Section IV.D.4.b.ii., the Commission estimates the total initial paperwork cost for complying with Rule 606(a)(1)(iv), as adopted, to be 2,920 hours, resulting in a cost of $986,960.[718] In addition, as discussed in Section IV.D.4.b.ii, the Commission estimates the total annual paperwork cost for complying with Rule 606(a)(1)(iv), as adopted, to be 4,380 hours, resulting in a cost of $1,093,540.[719]

More detailed disclosure about payment for order flow arrangements and profit-sharing relationships might impose other costs to customers that submit orders covered by Rule 606(a)(1) if it leads broker-dealers to decrease the amount of internalization used in the execution of market and marketable limit orders and to alter such arrangements and relationships. Broker-dealers have a variety of choices for order routing and execution, and the venue that a broker-dealer chooses may have a tangible effect on the execution quality of an order. Broker-dealers face conflicts of interest when routing orders, such as affiliations with trading centers, receipt of payment for order flow or receipt of payment from any profit-sharing relationship, and liquidity rebates. Similar to the discussion in Section V.C.2.c.ii., increased transparency from adopted Rule 606(a)(1)(iv) about payment for order flow arrangements and profit-sharing relationships could lead to subsequent scrutiny by customers and the public might lead broker-dealers to decrease the degree to which they internalize orders and route orders to high-rebate or low-fee exchanges to avoid the perception of conflicts of interest. If broker-dealers were to perceive the potential costs from increased transparency resulting from the

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[718] See supra note 576.

[719] See supra note 591.

enhanced disclosures to be relatively high compared to the benefit from sending orders to internalizers, then these orders might be more likely to be routed to trading centers other than internalizers, such as exchanges or alternative trading systems, regardless of potential execution quality differences such as relatively less price improvement, or they might be more likely to be routed to other lower rebate or higher fee venues, regardless of the potential execution quality differences. In addition, if broker-dealers were to reduce the order flow sent to internalizers who pay for it, the broker-dealers would receive less payment for such order flow and might pass the lost payments on to their customers by raising brokerage commissions or other fees. Similarly, if broker-dealers were to route such orders to trading centers with lower rebates and higher fees, they might pass the reduction in rebate revenue and increase in fee costs on to their customers by raising brokerage commissions or other fees.

e. Additional Amendments to Rule 606(a)(1) Disclosures

In addition to the amendments discussed above, the Commission is adopting other amendments to Rule 606(a)(1) reports.[720] The benefits and costs of these additional amendments are discussed below.

i. Replacement of Division of Rule 606(a)(1) Reports by Listing Market Division by S&P 500 Index and Other NMS Stocks

1. Benefits

The Commission believes that S&P 500 inclusion is an important determinant of execution quality and, therefore, is important for order routing strategies. In particular, a Commission staff analysis finds that the amendment to divide the Rule 606(a)(1) order routing reports required by securities included in the S&P 500 Index and other NMS stocks could provide customers with relevant information on how their orders are routed. Because the S&P

[720] See supra Sections III.B.4, 5 and 6.

500 index is correlated with certain liquidity and trading characteristics (which are a determinant of execution quality),[721] the reports under the amendment could more meaningfully reflect how broker-dealer routing varies with trading characteristics than do the public order handling reports prior to today's amendments.[722]

Specifically, the Commission staff analyzed execution quality as measured by effective spreads from Rule 605 reports ("Rule 605 data") for common stocks with S&P 500 index inclusion and on different market centers[723] to determine whether the execution quality of executing a market or a marketable limit order for common stock varies across market centers and S&P 500 index inclusion.[724] The staff's analysis controls for stock and order characteristics.[725] Accordingly, the staff's analysis considers whether execution quality depends

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721 S&P 500 stocks are in general larger and have more trading volume than non-S&P 500 stocks. Academic literature has shown that stocks with larger size and greater trading volume have smaller transaction costs than smaller stocks with lower trading volume. For example, see Tarun Chordia, Richard Roll, and Avanidhar Subrahmanyam, Commonality in liquidity, 56 Journal of Financial Economics 3–28 (2000); David Easley, Soeren Hvidkjaer, and Maureen O'Hara, Is Information Risk a Determinant of Asset Returns?, 57 Journal of Finance, 2185–2221 (2002).

722 The Commission recognizes that dividing such reports by three separate sections based on listing markets would still produce information that is useful to investors and, therefore, replacing the division of Rule 606(a)(1) reports by listing venues with a division by securities included in the S&P 500 Index and other NMS stocks could result in costs. These costs are discussed in Section V.C.2.e.i.2.

723 The analysis uses historical data from market centers as they existed during the indicated time period. The Commission notes that the names of some of the market centers have since changed.

724 The Commission purchased the Rule 605 data from CoreOne Technologies, a provider of financial data. The data used in this analysis spans from January 1, 2012, through September 30, 2017. The CRSP U.S. Stock Database from Wharton Research Data Services contains daily and monthly market and corporate action data for securities and is used to estimate control variables.

725 Specifically, to capture the effect of stock and order characteristics on execution quality, the analysis uses a regression analysis that controls for stock characteristics, such as dollar volume, market capitalization, and mean variance of daily returns, and order characteristics such as order type and order size. The regression analysis also controls for years to mitigate the effect of time variation on execution quality. In addition, the Rule 605 data weight the effective spread statistics equally by stock. Therefore, these effective spreads appear larger than if they were weighted by dollar volume or by share volume. The purpose of the analysis is to estimate the relative rankings of transaction costs across exchanges; therefore, the use of equally weighted effective spread has no impact on the economic analysis in a qualitative manner.

on S&P 500 index inclusion, and specifically which market centers provide better execution, as a means to assess the degree to which the amendment provides useful information.

While the staff's analysis is not a direct test of whether order routing differs for stocks included in S&P 500 versus those not included in the S&P 500,[726] it does directly measure one important factor in whether such routing information will be useful – differences in execution quality. Information on both execution quality and routing allows customers (or someone acting on behalf of customers) to assess the extent to which their broker-dealer routes customer orders to the market centers that provide better execution quality. If execution quality, as measured by effective spreads, shows that S&P 500 index inclusion matters for which market centers offer better execution quality, then including the index information could enhance the ability of customers to assess one of the components of best execution. Hence, the staff's analysis provides some indication of whether dividing the reports by S&P 500 inclusion, as required by the adopted amendment, would provide customers and the public with useful information regarding the impact of routing decisions.[727]

Table 2. Regression Results for the Association Between Execution Venue and Mean Effective Spread for Common Stocks.

Dependent variable	Mean Effective Spread (bp)		
	(1)		(2)
	Jan. 2012 - Aug. 2016		Oct. 2016 – Sept. 2017
Intercept	21.55***		20.28***
Market Center			
A	20.34***		17.84***

726 The direct test would be whether order routing differs for stocks included in S&P 500 versus those not included in the S&P 500, which would require quarterly reports for orders required by Rule 606(a). However, the quarterly reports are not filed with the Commission, and the staff was unable to obtain aggregated 606 reports from a vendor. Therefore, the Commission staff did not analyze 606 reports prior to today's amendments to see if routing differs by listing exchange of the stock.

727 The staff used Alphabets in Table 2 and Table 3 for each market center so that the identity of exchange is not revealed.

B	17.02***		18.45***
C	24.34***		12.28***
D	33.93***		---
E	15.43***		8.69***
F	20.40***		17.58***
G	26.28***		22.79***
H	43.36***		10.35***
I	19.38***		---
J	18.47***		–16.07***
K	86.64***		104.04***
L	21.55***		13.78***
M	5.89***		0.89**
N	---		19.70***
S&P500 Index	–12.40***		–18.96***
Interaction Terms			
S&P500 Index * A	–20.95***		–18.44***
S&P500 Index * B	–18.44***		–17.72***
S&P500 Index * C	–25.47***		–14.34***
S&P500 Index * D	–34.23***		---
S&P500 Index * E	–10.50***		–4.32***
S&P500 Index * F	–21.22***		–17.93***
S&P500 Index * G	–27.18***		–23.26***
S&P500 Index * H	–44.40***		–13.43***
S&P500 Index * I	–20.90***		---
S&P500 Index * J	–19.75***		17.74***
S&P500 Index * K	–84.79***		–100.83***
S&P500 Index * L	–21.55***		–13.34***
S&P500 Index * M	–6.95***		–2.14*
S&P500 Index * N	---		–18.54***
Observations	29,141,050		3,963,474
Adjusted R^2	5.06%		6.29%

Note: Data is from the Rule 605 reports and CRSP and includes years from 2012 to 2017. The variable categories that are dropped are: market orders, one trading venue, order size from 100-499 shares, and the 2012 calendar year (for the regression using data from January 2012 through August 2016). Note that the regression using data from October 2016 through September 2017 included quarter-fixed effects instead of year-fixed effects. Also, note that for the regression from October 2016 through September 2017, the analysis did not include CBSX and NSX data because these two exchanges stopped operating. The control variables are indicators for marketable limit order; order size for 500-1,999 shares, 2,000-4,999 shares, and ≥ 5,000 shares; and security specific variables including dollar volume, market capitalization, and daily return variance. *T*-statistics are estimated from White standard errors. *** indicates significance of a 2-tailed test at the 1% level, ** at the 5% level, and * at the 10% level. The Chi-square tests are used to test the null hypothesis that all of the exchange coefficients, with the exception of the intercept coefficient, are jointly zero. The pairwise *F* tests are used to test the null hypothesis that pairs of the exchange coefficients, with the exception of the intercept coefficient, are zero.

Table 2 presents the results of the staff's analysis of effective spreads for common stocks traded on all existing exchanges and off exchange, after controlling for differences due to stock and order characteristics. The methodology in the staff analysis does not allow the analysis to

treat IEX as a separate market center for the entire period because IEX data became available from September 2016, so the analysis divides the analysis into two subperiods.[728] Column 1 reports the result for the first sub-sample period, and column 2 reports the result for the second sub-sample periods. The market center rows in the table report the basis point difference between the average effective spreads on that market center and the average effective spreads on the NYSE. The S&P 500 index rows in the table report the basis point difference between the average effective spreads on S&P 500 stocks and the average effective spreads on non-S&P 500 stocks. The rows for interaction terms of each market center and the S&P 500 index in the table report the basis point difference between the average effective spreads of S&P 500 stocks on that market center and the average effective spreads on the NYSE.

For illustration, the intercept in Column 1 indicates that the average effective spread for market order NMS stocks that are executed on the NYSE is 21.55 basis points. The 20.34 estimate for Exchange A indicates that the effective spreads on Exchange A are 20.34 basis points greater than those on the NYSE. The estimate –12.04 for S&P 500 index indicates that the effective spreads for S&P 500 stocks are 12.04 basis points less than non-S&P 500 stocks. And, the estimate for the interaction between Exchange A and the S&P 500 index indicates that the effective spreads for S&P 500 stocks traded on Exchange A are 20.95 basis points lower than NYSE stocks on average.[729]

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728 The staff did several analyses because CBSX data is available until January 2014 and NSX data is available until May 2014. Staff conducted similar analysis without these two exchanges and during the time period that all the exchanges in the sample were operating. These regression analyses change the estimated coefficients in the regression analysis; however it does not change the conclusion that reporting divided by S&P 500 index and other NMS securities, as in the adopted amendment, could provide relevant information on execution quality to customers and the public. The additional analyses provide more robust analysis to support the staff's conclusion.

729 For perspective, a one-penny effective spread on a $40 stock is 2.5 basis points. A 2.5 basis point cost on a 100-share trade in a $40 stock would be $1.00.

The analysis of Table 2 suggests that partitioning the Rule 606 reports by S&P 500 index inclusion will be useful. Specifically, the structure of the regressions in Table 2 allows for a ranking of the exchanges by effective spread to gauge whether the exchanges that provide the better execution quality in S&P 500 stocks are different than those that provide the better execution quality in other NMS stocks. If the relative ranking of exchanges in S&P 500 stocks is similar to the relative ranking in other NMS stocks, then partitioning the order routing reports by S&P 500 inclusion would not provide information useful for considering the impact of broker-dealer routing on execution quality.

Upon examination, Table 2 shows that the ranking of the market centers by effective spreads is different depending on stocks in that market center being included in the S&P 500 index. For example, the five market centers with the best execution quality relative to the NYSE traded stocks are Exchange M, E, B, J, and I, in descending order. However, in comparing S&P 500 stocks that are traded in these five trading centers, the ranking of the market centers for S&P 500 stocks by effective spreads changes. For S&P 500 stocks, the five market centers that have the best execution quality relative to the NYSE traded stocks are stocks traded on Exchange I, A, J, C, and M, in descending order.[730] This indicates that there seem to be differences between market centers in terms of effective spreads for stocks, depending on whether they are included in the S&P 500 index, which may inform customers in assessing the execution quality their broker-dealers provide.

Commenters suggested removing the requirement that the report be divided by listing market and separating reports by S&P 500 and non-S&P 500 stocks because the division based

[730] The analysis in Table 2 uses an indicator for each market center, an indicator for being included in the S&P 500 index, and an interaction term between each market center and the S&P 500 index. To obtain the rankings for execution quality for S&P 500 stocks, Commission staff summed the three estimates and compared the relative magnitudes of the summed estimates across market centers.

on the S&P 500 index could give retail customers more meaningful data, as S&P 500 stocks have the largest market capitalization and have significant retail customer interest. Commenters mentioned that S&P 500 stocks, therefore, could have a different correlated execution quality level than lower volume issuances, providing useful information to retail customers.[731] Therefore, the staff's analysis indicates that reporting divided by the S&P 500 index and other NMS securities, as in the adopted amendment, could provide relevant information about execution quality to customers and the public.

2. Costs

The amendment to Rule 606(a)(1), as adopted, will result in initial compliance costs to prepare separate disclosures and ongoing costs to adjust reporting when the constituents of the S&P 500 change. The Commission acknowledges that the S&P 500 index is a proprietary index, which is accessible via a fee-based subscription. The Commission also notes that the list of S&P 500 index stocks is readily available on the internet on many free websites and thus obtaining the constituents of the index should be at a minimal cost to broker-dealers. Moreover, as discussed in Section III.B.5.b., many data dissemination services obtain this information from the S&P and redistribute this information as part of data packages consumed by broker-dealers as a part of the broker-dealers normal course of business. Thus, the Commission believes that there will be few or no additional data costs to broker-dealers resulting from this requirement.

Additionally, on the basis of staff analysis, not separating order routing reports by primary listing market could also reduce some informational value relative to the public order handling reports prior to today's amendments. In particular, the staff analysis indicates that removal of primary listing exchanges could reduce the value of the 606(a)(1) reports for

[731] See, e.g., Schwab Letter at 3 and Fidelity Letter at 9.

monitoring execution quality from broker-dealers, because reporting by listing exchange still provides information distinct from the S&P 500 index.

Table 3. Regression Results for Association between Execution Venue and Mean Effective Spread for Common Stocks by Listing Exchange.

Dependent variable		Mean Effective Spread (bp)						
Time Period		Jan. 2012 through Aug. 2016				Oct. 2016 through Sept. 2017		
		(1)	(2)	(3)		(4)	(5)	(6)
Listing Exchange		NYSE	NASDAQ	AMEX		NYSE	NASDAQ	AMEX
Intercept		18.60***	84.35***	161.47***		21.56***	37.48***	122.29***
Market Center								
A		–3.47***	–28.39***	–35.13***		–8.26***	9.29***	–21.38***
B		–5.94***	–31.49***	–39.39***		–5.93***	9.40***	–20.29***
C		–1.21***	–22.82***	–29.22***		–8.80***	3.51***	–18.16***
D		1.91***	–11.55***	17.93***		---	---	---
E		–0.33	–33.79***	–12.66*		–6.66***	–0.56	–13.72**
F		–4.14***	–28.61***	–34.00***		–6.77***	8.83***	–20.01***
G		–3.84***	–21.70***	–28.93***		–6.38***	14.40***	–18.29***
H		1.31***	---	–0.76		–11.02***	---	–24.29***
I		–2.60***	–31.09***	–38.77***		---	---	---
J		–5.85***	–30.22***	–41.11***		–3.40***	–18.52***	–19.06***
K		---	–41.56***	---		---	–7.89 **	---
L		–2.93***	–27.01***	–33.85***		–9.86***	5.08***	–28.33***
M		–2.56***	–48.71***	–69.04***		–11.74***	–11.35***	–39.14***
N		---	---	---		–4.73***	11.52***	–16.31***
S&P500 Index		–12.86***	–72.80***	---		–18.44***	–42.56***	---
Interaction Terms								
S&P500 Index * A		2.73***	29.10***	---		6.95***	–4.94***	---
S&P500 Index * B		4.33***	31.40***	---		6.21***	–4.14***	---
S&P500 Index * C		0.50***	22.69***	---		7.23***	–1.43 **	---
S&P500 Index * D		–0.67***	11.56***	---		---	---	---
S&P500 Index * E		4.34***	44.30***	---		10.26***	11.49***	---
S&P500 Index * F		3.40***	28.77***	---		6.02***	–4.43***	---
S&P500 Index * G		2.99***	21.97***	---		5.57***	–10.07***	---
S&P500 Index * H		–2.27***	---	---		9.09***	---	---
S&P500 Index * I		2.27***	30.15***	---		---	---	---
S&P500 Index * J		4.16***	30.29***	---		5.06***	20.47***	---
S&P500 Index * K		---	43.18***	---		---	12.26***	---
S&P500 Index * L		2.22***	28.53***	---		9.07***	0.59	---
S&P500 Index * M		2.15***	48.26***	---		10.94***	14.03***	---
S&P500 Index * N		---	---	---		5.58***	–5.78***	---
Observations		13,258,370	15,015,886	864,846		1,776,195	2,085,181	102,046
Adjusted R^2		7.55%	3.35%	4.11%		11.43%	4.26%	5.84%

Note: Data is from the Rule 605 reports and CRSP, and includes years from 2012 to 2017. The variable categories that are dropped are: market orders, one trading venue, order size from 100-499 shares, and the 2012 calendar year (for the regression using data from January 2012 through August 2016). Note that the regression using data from October 2016 through September 2017 included quarter-fixed effects instead of year-fixed effects. Also, note that for the regression using data from October 2016 through September 2017, the analysis did not include CBSX and NSX because these two exchanges stopped operating. The control variables are indicators for marketable limit order; order size for 500-1,999 shares, 2,000-4,999 shares, and ≥ 5,000 shares; and security specific variables including dollar volume, market capitalization, and daily return variance. *T*-statistics are estimated from White standard errors. *** indicates significance of a 2-tailed test at the 1% level, ** at the 5% level, and * at the 10% level. The Chi-square tests are used to test the null hypothesis that all of the exchange coefficients, with the exception of the intercept coefficient, are jointly zero. The pairwise *F* tests are used to test the null hypothesis that pairs of the exchange coefficients, with the exception of the intercept coefficient, are zero.

Similar to Table 2 in Section V.C.2.d.i.1., the staff's analysis focuses on whether customers or others can use the market-specific routing information to assess the execution quality they get from their broker-dealers. Specifically, if the order routing decisions by broker-dealers differ by the exchanges where stocks are listed, e.g., if broker-dealers route orders differently for NYSE-listed stocks compared to NASDAQ-listed stocks, the removal of listing exchanges from the reports will not provide this information to customers and the public.[732] Such information can be useful for customers and the public, as long as order routing decisions determine execution quality. Specifically, Commission staff analyzed execution quality as measured by effective spreads from Rule 605 reports for common stocks with different primary listing exchanges, with different market centers, and with S&P 500 index information to determine whether the cost of executing a market or a marketable limit order for common stock varies across market centers and primary listing exchanges, while also accounting for the effects of the S&P 500 index inclusion.

[732] The Commission notes that there are differences in order routing decisions depending on the primary listing exchange because of existing rules, regulations, and practices. For example, the NYSE does not trade NASDAQ- or NYSEAMER-listed stocks. As a result, orders for a NYSE-listed stock can be routed to the NYSE, NASDAQ, and other market centers, whereas orders for NASDAQ-listed stocks can be routed to NASDAQ and other market centers, but not to the NYSE. This level of information will be lost when reporting by primary listing exchanges is removed.

In the Proposing release, the Commission reported the results of a staff analysis that found that reporting order routing information by listing exchange would provide useful information and, therefore, removing this partition would impose a cost on investors. Because the Commission is adopting a different partition than proposed, specifically replacing a listing-exchange partition with a partition based on S&P 500 inclusion, the Commission staff has revised its analysis to examine whether a listing-exchange partition would provide useful information beyond that information investors could learn from S&P 500 inclusion. Specifically, the analysis examines whether, after accounting for S&P 500 inclusion, listing exchange still affects the relative rank of costs to trade on the various market centers. Such a result would indicate that an S&P 500 partition is not a direct substitute for all of the information captured by a listing-exchange partition. The staff's analysis controls for stock and order characteristics.[733] Accordingly, the staff's analysis considers whether execution quality depends on primary listing exchanges in addition to S&P 500 index inclusion as a means to assess whether the amendment might reduce some of the usefulness of the reports.[734]

Table 3 presents the results of the staff's analysis of effective spreads for common stocks listed on the NYSE, NASDAQ, and AMEX. Columns 1 through 3 report the results for each of these primary listing exchanges. The market center rows in the table report the basis point difference between the average effective spreads on that market center and the average effective spreads on the primary listing exchange. The S&P 500 index rows in the table report the basis point difference between the average effective spreads on stocks that are included in the S&P 500 index and the average effective spreads on each listing exchange. The rows for interaction

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733 See supra note 725.

734 See Section 0.C.0.0.0.0, which discusses the usefulness of using execution quality measures in the analysis.

terms of each market center and S&P 500 index in the table report the basis point difference between the average effective spreads of S&P 500 stocks on that market center and the average effective spreads on each listing exchange.

As an illustrative example, the intercept in Column 1 indicates that the average effective spread for market orders for NYSE-listed stocks that are executed on the NYSE is 18.60 basis points and the –3.47 estimate for Exchange A indicates that the effective spreads for NYSE-listed stocks traded on Exchange A are 3.47 basis points lower after controlling for differences due to stock and order characteristics. The –12.86 estimate for the S&P 500 index indicates that the effective spreads for S&P 500 stocks are 12.86 basis points less than non-S&P 500 index stocks, and the 2.73 estimate for the interaction between Exchange A and the S&P 500 index indicate that the effective spreads for S&P 500 stocks that are traded on Exchange A are 2.73 basis points higher.

Table 3 indicates that the average effective spreads vary significantly by the market center where the orders were executed. Table 3 shows that most market center effective spreads are significantly different than those of the listing exchange. For example, after controlling for the effect of stock and order characteristics and the effect of the S&P 500 index inclusion, Column 1 shows that, for NYSE-listed stocks, the average effective spread on Exchange A is 3.47 basis points less than on the NYSE itself, and the average effective spread on NASDAQ is 1.31 basis points higher than on the NYSE. Table 3 also indicates that the average effective spreads vary significantly by listing exchange. For example, the staff's analysis suggests that NASDAQ-listed stocks tend to have higher average effective spreads than NYSE-listed stocks

because the intercept estimates are much larger in Column 2 compared to Column 1.[735] Table 3 also shows that AMEX-listed stocks tend to have even higher average effective spreads than NASDAQ-listed stocks by comparing the results in Column 3 with those in Column 2.

The results in the table suggest that because the relative ranking of each market center changes depending on the listing exchange, the adopted amendment to remove listing exchanges from the report could reduce the usefulness of Rule 606 reports. If the ranking of the effective spreads on each market center were the same across the three primary listing exchanges, where a stock is listed will have little or no relationship to whether order routing information informs on execution quality. Such a result implies that removing listing exchanges from order routing reports would not reduce the amount of information in the reports. However, upon examination, Table 3 shows that the ranking of the market centers by effective spreads is different depending on the primary listing exchange even after considering the effect of the S&P 500 index.

For example, the five market centers that have the best execution quality relative to the NYSE-listed stocks are Exchange B, J, F, G, and A, in descending order. However, for the same NYSE-listed stocks, the ranking of the market centers for S&P 500 stocks by effective spreads changes. For S&P 500 stocks, the five market centers that have the best execution quality relative to the NYSE-listed stocks are Exchange J, B, H, G, and L, in descending order.[736]

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735 The Commission recognizes that the staff analysis did not control for stock and order characteristic differences across the columns, and the staff did not estimate a matched- sample comparison. These other analysis types would facilitate a more fulsome comparison of effective spreads in similar stocks by listing exchange than the staff's analysis in Table 3. However, because the 606 reports do not distinguish individual stocks, the Commission believes that the staff analysis is appropriate for assessing the costs of the adopting amendments.

736 The analysis in Table 3 includes an indicator for each market center, an indicator for being included in the S&P 500 index, and an interaction term between each market center and S&P 500 index for each listing exchange. Therefore, in order to obtain the rankings for execution quality for S&P 500 stocks, Commission staff calculated the sum of the three estimates and compared the relative magnitudes of the summed estimate across market centers for each listing exchange.

Similarly, the five market centers that have the best execution quality relative to the NASDAQ-listed stocks are Exchange M, K, E, B, and I, in descending order. However, for the same NASDAQ-listed S&P 500 stocks, the five market centers that have the best execution quality relative to the NASDAQ-listed stocks are Exchange B, C, F, A, and L, in descending order. The analysis indicates that there seem to be differences among market centers in terms of effective spreads for stocks with different primary listings. The Commission acknowledges that the staff's analysis presented in Table 3 may not be a perfect test of assessing whether the partition based on S&P 500 index inclusion relative to the omission of information of listing venues would have more useful information in the report. Instead, the staff analysis assesses whether S&P 500 inclusion encompasses all of the information in the listing exchanges. Specifically, the staff's analysis shows that listing venues contain information relevant to execution quality, and therefore, broker-dealers' order routing, after accounting for the effects of S&P 500 index inclusion.

On the basis of the staff's analysis, the Commission recognizes that replacing the listing exchange partition with an S&P 500 index partition, as in the adopted amendment, could provide additional information to customers and the public, as discussed in Section V.C.2.e.i.1. At the same time, the Commission also acknowledges that eliminating the listing information from the report required by Rule 606(a)(1), as in the adopted amendment, could reduce the information content of the reports.

The Commission recognizes that because the amendments change which orders are covered by Rule 606(a)(1), the analysis does not directly provide evidence of the costs of eliminating the listing information from the report, but rather provides an indication of potential costs. The public order handling reports will cover a different set of orders than are covered in

the Rule 605 data, and the Rule 605 data do not have information to distinguish orders covered by Rule 606(a)(1) from orders covered by Rule 606(b)(3). Therefore, Commission staff cannot conduct a separate analysis for orders covered by Rule 606(a)(1). The Commission believes, however, that it can reasonably assume that execution quality for orders covered by Rule 606(a)(1) is sufficiently correlated with the execution quality for orders covered by Rule 606(b)(3) for the analysis to provide informative results because exchanges have few mechanisms that would treat the orders differently.

ii. Other Amendments to Reporting

The Commission believes that the amendments to Rule 606(a)(1) to require quarterly public order routing reports to be broken down by calendar month will allow customers to better assess whether their broker-dealers' routing decisions are affected by changes in fee structures and the extent to which such changes affect execution quality. Multiple commenters stated that disclosing the information contained in the public routing reports by calendar month could enable customers to better assess and monitor broker-dealers' routing decisions.[737] This adopted amendment will, however, require an initial cost to change the process for completing the reports. The Commission believes this cost to be small because broker-dealers typically process data daily and reporting the data broken down by month will be a change only in the aggregation of the data, from quarterly to monthly.

In addition, the Commission is adopting the requirement that the public order routing report required by Rule 606(a)(1) and the customer-specific order routing report required by Rule 606(b)(1) be made available using an XML schema and associated PDF renderer published on the Commission's website. The benefits and costs associated with this requirement are

[737] See, e.g., Markit Letter at 29; Fidelity Letter at 9

discussed in Section V.C.4. The Commission believes that requiring both the public and the customer-specific order routing reports to be provided in this format should be useful to customers, as it will allow them to more easily analyze and compare the data provided in both types of reports across broker-dealers, for the reasons discussed above.[738] The amendments to Rule 606(a)(1) and Rule 606(b)(1), as adopted, will require an initial cost to change the process for completing the reports.[739]

Finally, the Commission is amending Rules 605(a)(2) and 606(a)(1), as adopted, to require market centers and broker-dealers to keep the reports posted on a website that is free and readily accessible to the public for a period of three years from the initial posting on the website. As commenters stated,[740] such analysis may lead to increased transparency with regard to execution quality and may lead broker-dealers to compete along this dimension through routing decisions, resulting in a higher probability of execution and improved execution in terms of costs. Under the adopted amendments to Rule 605(a)(2) and 606(a)(1), customers and the public could examine the order execution of a market center and broker-dealers' order routing through time.

Regarding the requirement to make the reports available for three years, the Commission believes that, once the report is posted, maintaining the reports on the website will not pose any additional burden on broker-dealers, and thus any additional costs to maintain the report on the website will be negligible.[741] In addition, the adopted amendment could impede third-party vendors that aggregate the time series of 605 and 606 reports because customers may find third-

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738 See supra Section 0.A.0.

739 The benefits and costs associated with this requirement more generally are discussed in Section 0.C.0.

740 See, e.g., Citadel Letter at 1; Markit Letter at 29.

741 See infra Section 0.0.0.0.

party services less useful, particularly for the three years that the reports are publicly available. As a contrast, the customers of third-party vendors could avoid costs associated with third-party sources because under the adopted amendment, customers could directly access the information for the three-year period.

f. Compliance Costs for Rule 606(a)(1) Order Routing Reports

As discussed in more detail in Section IV.D.4., the Commission estimates the costs to comply with the amendments to Rule 606(a) that require broker-dealers to distinguish between marketable and non-marketable limit orders and with adopted Rule 606(a)(1)(iii) that requires disclosure of net payment for order flow and transaction fees and rebates by Specified Venue are as follows.

As discussed in Section IV.D.4.ii., the Commission estimates that the initial hourly burden will be 240 hours[742] for a broker-dealer that routes orders subject to the disclosures required by Rule 606(a)(1) to both update its data capture systems and format the report required by the rule, resulting in a monetized cost burden of $76,800 per broker-dealer.[743] The Commission estimates that the one-time, initial burden for a broker-dealer that routes orders subject to the disclosures required by Rule 606(a)(1) and that does not currently create the required order handling information to engage a third-party to program its systems to implement the requirements of the amendments to Rule 606(a) will be 20 hours, resulting in an estimated monetized cost burden of $6,410 per broker-dealer.[744] Also, as discussed in Section IV.D.4.ii, the Commission further estimates a fee of $32,000 per broker-dealer to reflect the complexities

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742 See supra note 566.

743 See id.

744 See supra note 567.

associated with requiring broker-dealers to distinguish between marketable and non-marketable limit orders.

The Commission estimates that all 292 broker-dealers that route orders covered by Rule 606(a)(1) will need to update their systems to capture the information required by the rule. The Commission believes that some broker-dealers will implement the changes in-house, while others will engage a third party vendor. Accordingly, the Commission believes that it is reasonable to estimate that one third of the 292 broker-dealers that route such orders – 97 broker-dealers – will implement the changes in-house, while the remaining number – 195 broker-dealers will engage a third-party vendor to do so.[745]

The Commission estimates the initial burden for broker-dealers that will program their systems in-house to capture the data and produce a report to comply with the rule as 23,280 hours.[746] The Commission estimates that the total initial cost for broker-dealers that will engage a third-party vendor to program their systems to capture the data and produce a report to comply with the rule as 3,900 hours and $6,240,000.[747]

Therefore, the Commission estimates that the total initial burden to comply with Rule 606(a) for all 292 broker-dealers that the Commission estimates route retail orders is 27,180 hours, resulting in a monetized cost burden of $8,699,550,[748] plus an additional cost of $6,240,000[749] to third-party service providers.

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745 See supra note 560.

746 See supra note 568.

747 See supra note 570.

748 See supra notes 572.

749 See supra note 570.

The Commission believes that once the initial costs described above have been incurred to allow a broker-dealer to obtain the required information, the cost to produce a quarterly report will remain the same compared to a quarterly report previously required under Rule 606(a).[750] However, broker-dealers will need to monitor payment for order flow or profit-sharing relationships and potential SRO rule changes that could impact their order routing decisions and incorporate any new information into their reports. Thus, the Commission estimates the annual burden for a broker-dealer to comply with the adopting amendments to Rule 606(a)(1)(i) through (iii) to be 10 hours, resulting in a monetized cost burden of $3,380.[751] With 292 broker-dealers that route retail orders required to comply with the adopting amendments, the Commission estimates the total annual burden to be 2,920 hours, resulting in a monetized cost burden of $986,960.[752]

As discussed in Section IV.D.4.a.ii., because Rule 606(b)(1) prior to today's amendments applies to all customer orders, broker-dealers must now modify their systems to provide the disclosures for the following types of orders, regardless of market value: (i) orders in NMS stocks that are submitted on a held basis; (ii) orders in NMS stocks that are submitted on a not held basis and are exempt from the disclosure requirements of Rule 606(b)(3); or (iii) orders in NMS securities that are option contracts.

The Commission believes that it is reasonable to estimate that one third of the 292 broker-dealers that route orders subject to the disclosures required by Rule 606(b)(1) – 97 broker-dealers – will implement these changes in-house, while the remaining number – 195

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750 See supra Section 0.0.0.0.

751 See supra note 574.

752 See supra note 576.

broker-dealers – will engage a third-party vendor to do so.[753] The Commission estimates the initial burden for a broker-dealer that will program its systems in-house to comply with Rule 606(b)(1) as 24 hours.[754] The Commission estimates the initial burden for a broker-dealer that will engage a third-party vendor to program its systems to comply with the rule as 3 hours and $979[755].

Therefore Commission estimates the total initial burden for all 292 broker-dealers to program their systems to comply with Rule 606(b)(1) as 2,913 hours[756] and $975,000.[757]

As discussed in Section IV.5., the amendments being adopted today add several defined terms to Rule 600 of Regulation NMS which will impose an initial burden on market centers and the broker-dealers that will have to review and update compliance manuals and written supervisory procedures and update citation references to any such defined term. The Commission estimates that it will take each of 381 market centers and 4,024 broker-dealers two hours to make these updates in house at a one-time burden of two hours for each respondent.[758] Therefore the Commission estimates the total initial cost to be 8,810 hours.[759] As discussed in Section IV.5, there is no annual burden associated with this requirement.

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753 See supra note 560.

754 See supra note 578.

755 See supra note 579.

756 See supra note 581.

757 See supra note 582.

758 See supra note 592.

759 See supra note 593.

3. Disclosure of Order Execution Information

The adopted amendment to Rule 605(a)(2) requires market centers to keep reports required pursuant to Rule 605(a)(1) posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website.

a. Benefits

Similar to the analogous requirements in Rules 606(a), as adopted, described above, the Commission believes that requiring the previous three years of past order execution information to be available to customers and the public generally should be useful to those seeking to analyze historical order execution information at various market centers. This will allow broker-dealers to compare different market centers more easily, market centers to compare themselves to other market centers more easily, and third-party vendors to provide their services on the basis of the data more easily. Several commenters stated that the adopted amendment to Rule 605(a)(2) could better enable investors to evaluate the impact that routing decisions have on the quality of their order executions and provide information regarding broker-dealers' potential conflicts of interest.[760]

b. Costs

As discussed in Section V.C.2.e. above, the Commission believes that the costs to market centers for making the order execution reports readily accessible to the public for a period of three years from the date of initial publication are negligible. In addition, specifying a minimum length of time for making the Rule 605 reports available may make the data owned by third-party

[760] See, e.g., Angel Letter at 3-5; Dash Letter at 2-3; FSR Letter at 1.

vendors aggregating the time series of 605 reports less useful because, for three years, the data will be publicly available and more easily accessible.

4. Structured Format of Reports

The Commission is adopting the requirement that the Rule 606(b)(1) order routing and Rule 606(b)(3) order handling reports be made available using the Commission's XML schema and associated PDF renderer. The Commission is also adopting the requirement that the public order handling reports required under Rule 606(a)(1) be made available using an XML schema and associated PDF renderer published on the Commission's website. As discussed earlier, the Commission believes that requiring the reports to be made available in an XML format will facilitate enhanced search capabilities and statistical and comparative analyses across broker-dealers and date ranges.[761] In addition, the associated PDF renderer will provide users with an instantly human-readable format for those who prefer to review manually individual reports, while still providing a uniform presentation. Multiple commenters stated that presenting the data in a consistent, machine readable format such as XML could make data analysis easier and could enable customers to make more informed decisions in selecting broker-dealers.[762]

The Commission understands that varying degrees of structuring have varying costs. Most, if not all, broker-dealers already have experience applying the XML format to their data. For example, all FINRA members must use FINRA's Web EFT system, which requires that all data be submitted in XML.[763] For the end users, with the data in the reports structured in XML, they could immediately download the information directly into databases and analyze it using

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761 See supra Section 0.A.0.

762 See FIF Letter at 17; CFA Letter at 11; FIA Letter at 1; HMA Letter at 12; Markit Letter at 17, 28; and Better Markets Letter at 2.

763 See http://www.finra.org/industry/web-crd/web-eft-schema-documentation-and-schema-files.

various software. This will enhance their ability to conduct large-scale analysis and immediate comparison of broker-dealers across date ranges. Moreover, as an open standard, XML is widely available to the public at no cost.

The Commission also believes that if the reports are provided in a structured format, users could avoid costs associated with third-party sources that might otherwise extract and structure the data and then charge for access to that structured data. Users could also avoid the additional time it would take for them to manually review and individually structure the data if they wanted to conduct large-scale analysis, comparison, or aggregation. The Commission also acknowledges that the required reporting in structured format could hurt certain third-party vendors that charge for access to structured data of data reported in an unstructured format, because customers may find that third-party service is less useful for them. However, without the need to spend time in manually reviewing and rekeying the unstructured information for analysis, some third-party vendors may be able to conduct more comprehensive analysis in a more timely fashion than they could have offered previously.

The XML schema will also incorporate certain validations to help ensure consistent formatting among all reports help to ensure data quality. However, these validations will not be designed to ensure the underlying accuracy of the data.

The Commission considered alternative formats to XML, such as CSV and XBRL. The Commission does not believe the CSV format is suitable, because it does not lend itself to validations. As a result, the data quality of the reports will likely be diminished as compared to XML, impairing comparability, aggregation, and large-scale analysis. While the XBRL format enables users to capture the rich complexity of financial information presented in accordance with U.S. Generally Accepted Accounting Principles, XBRL is not necessary to accurately

capture the information for the required reports. The Commission believes the simpler characteristics of the information in the required reports are better suited for XML.

Two commenters raised concerns regarding the need for providing such reports in the XML/PDF format specifically of the Rule 606(b)(1) reports, stating that customers rarely request these reports, and stating their view that the cost of implementing the proposed format would outweigh the benefits.[764] However, for the reasons stated above, the Commission believes providing these reports in XML has benefits and would not impose substantial costs to broker-dealers to produce the XML/PDF format of the reports. To the extent that broker-dealers would need to abide by the requirement of Rule 606(b)(1) only when customers request such reports, and, as discussed in Section V.C.1.a.ii., to the extent that customers typically placing held orders may not have a need for additional customer-specific reports required by Rule 606(b)(1) and therefore would not frequently request such reports, Rule 606(b)(1) would not impose significant ongoing compliance costs to broker-dealers to create the XML/PDF format of the reports. Moreover, as discussed in Section V.C.1.a.i., although customers placing held orders would rarely request reports set forth in 606(b)(1), customers will have an option to request additional information if they choose to do so. As a result, customers that request 606(b)(1) reports would be able to better compare and monitor broker-dealers' order handling practices, which could promote better execution quality of held orders and competition among broker-dealers. Therefore, the Commission believes that the use of the XML/PDF format will enable customers to more easily analyze and compare the individualized data provided.

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764 See Thomson Reuters Letter at 2; FIF Letter at 9, 12.

5. Other Definitions in Adopted Amendments to Rule 600

a. Definition of Non-Marketable Limit Order in Adopted Rule 600(b)(54)

The Commission believes that the amendments to Rule 600(b)(54) will help ensure consistent and correct interpretation and application of the adopting amendments to Rule 606(a)(1) for retail orders. The Commission also believes that there are no costs associated with adopting Rule 600(b)(54), because it is a definition that is widely used by market participants.

b. Definitions of "Orders Providing Liquidity" and "Orders Removing Liquidity" in Adopted Rule 600(b)(58) and (59)

The Commission believes that Rules 600(b)(58) and (59), as adopted, will help ensure consistent and correct interpretation and application of Rule 606(b)(3), as adopted, for institutional orders. The Commission also believes that there are no costs associated with adopted Rules 600(b)(58) and (59) because the Commission understands that the two definitions are widely used by market participants.

D. Alternatives Considered

1. Alternative Scope for the Customer-Specific Reports

In addition to the alternative of adopting the proposed $200,000 threshold in the definition of "institutional order," as discussed above, the Commission also considered an alternative in which the Commission would adopt a new entity-centric definition of "institutional order" and require order handling disclosure in Rule 606(b)(3) for such "institutional" orders. Several commenters suggested that the applicability of the customer-specific disclosures be based on the entity placing the order.[765] The entity-centric approach could be based on the

[765] See ICI Letter at 6-7; MFA Letter at 3; Fidelity Letter at 3; STA Letter at 4; CFA Letter at 8; SSGA Letter at 1; CFA Letter at 8; Bloomberg Letter at 13.

definition of "institutional order," that draws from FINRA Rules 2210(a)(4) and 4512(c) in defining an institutional order.[766]

The definition of "institutional investor" in FINRA Rule 2210(a)(4) and the definition of "institutional account" in FINRA Rule 4512(c) are well-established existing definitions that are familiar to most market participants and apply to entities that the Commission believes are broadly considered to be institutional by market participants. Therefore, broker-dealers' familiarities with FINRA definitions would facilitate compliance with and might reduce potential compliance costs for such a definition for participants already familiar with the FINRA rules. In addition, commenters suggested that funds are considered to be institutional market participants and that their orders should qualify as institutional orders,[767] and one commenter specifically characterized private funds as traditional institutional investors.[768] This is consistent with the Commission's understanding, as reflected by its statement in the Proposing Release that a hedge fund – a type of private fund – is an example of a type of institutional customer,[769] that market participants are accustomed to considering private funds to be institutional investors.

The Commission recognizes that the alternative definition, which is an entity-based definition of an institutional order, would capture most orders submitted by institutional market participants and is likely to reduce the potential misclassification of institutional orders as non-institutional orders and vice versa. The Commission also recognizes that the scope of FINRA Rules 2210(a)(4) and 4512(c), as incorporated into the definition of institutional order in the alternative, is generally tailored to cover the broad range of institutions that would likely benefit

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766 See supra Section 0.A.0.0.0.

767 See ICI Letter at 6; IDC Letter at 1-2; Capital Group Letter at 3; Ameritrade Letter at 1-2.

768 See Dash Letter at 3.

769 See Proposing Release, supra note 1, at 49433 n.1.

from the order handling disclosures required by Rule 606(b)(3), while minimizing the potential misclassification of institutional orders. However, as explained below, the Commission did not adopt this alternative.

As discussed in Section III.A.1.b.ii., the entity-centric approach suggested by commenters would require the Commission to set forth the types of customers that may request the Rule 606(b)(3) disclosures for their NMS stock orders, but would not entail any differentiation in the types of orders covered by Rule 606(b)(3). As result, NMS stock orders from qualifying customers that are submitted on a held basis would be covered by the Rule 606(b)(3) disclosures. This is a suboptimal outcome that is avoided by the adopted order type-based approach to Rule 606(b)(3)'s applicability. Including held orders within the Rule 606(b)(3) disclosures would be inconsistent with the purpose of the disclosures to provide insight into how a broker-dealer exercises order handling and routing discretion because broker-dealers must attempt to execute held orders immediately and are provided no discretion in handling them. Moreover, including a customer's held orders in the Rule 606(b)(3) report could obfuscate the reports' depiction of the discretion actually exercised by the broker-dealer. Order handling and routing behavior dictated by the fact that the customer submitted a held order could be misunderstood in the report as the product of broker-dealer discretion.

The alternative approach also would require the Commission to prescribe institutional status criteria that customers must fit in order to be entitled to receive the disclosures. A risk with such an approach is that the criteria could be over-inclusive or under-inclusive. The Commission is particularly concerned about potential under-inclusiveness because customers that do not fit the criteria would not be entitled to receive the disclosures. Under FINRA Rule 4512, a broker-dealer is not required to obtain for "institutional accounts" certain additional

information that it is required to obtain for accounts that are not "institutional accounts."[770] Likewise, under FINRA Rule 2210(a)(4), a broker-dealer is subject to less prescriptive review requirements for "institutional communications" that are solely to "institutional investors" than it is subject to for other, "retail communications."[771] Under both of these FINRA rules, exclusion from the defined "institutional" criteria triggers a more stringent due diligence or review obligation for the broker-dealer. The opposite would be true under an entity-centric approach to Rule 606(b) – if the institutional status criteria adopted by the Commission were not met, the market participant would be excluded from the more detailed disclosure regime.[772]

The alternative could create costs to customers because of misclassification of orders if broker-dealers are not able to easily discern whether an order meets the definition to be included in the customer-specific reports. Specifically, orders for NMS stock from persons that have total assets under $50 million and that are not a type of market participant expressly covered by the adopted definition would not be included in the reports under the alternative. Broker-dealers would not be obligated to provide these persons with the order handling disclosures in the adopted Rule 606(b)(3), because these persons do not fall within the definition under this alternative. Therefore, these persons would not benefit from the increased order handling transparency provided for in new Rule 606(b)(3). These persons instead would receive the order handling disclosures made available by amended Rule 606(b)(1).[773]

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770 See FINRA Rule 4512(a)(2).

771 See FINRA Rule 2210.

772 See supra Section 0.A.0.0.

773 Additionally, if an institutional order were misclassified as a retail order, the order would be subject to the Rule 606(a)(1) and Rule 606(b)(1) order routing disclosure requirements, therefore reducing the accuracy of public retail order routing reports and reducing the benefits of increased transparency of retail order routing disclosure that are discussed in Section V.C.2.a.ii.

Furthermore, the alternative could create costs to retail investors due to misclassification of orders if broker-dealers cannot easily discern whether an order meets the definition of a retail order. Such a misclassification would exclude retail market participants that should be included, or include an institutional market participant that should be excluded. Under this scenario, the 606(a)(1) report could contain less accurate information regarding retail order routing, reducing the benefit of increased transparency of the public retail order report. Also, because misclassified retail orders would be subject to the requirements of 606(b)(3) reports under the adopted rule, retail investors would not receive the benefit of 606(a)(1) reports. As discussed in Section V.C.1.a.i.1., information pertinent to understanding broker-dealers' order handling practices for customers' orders that retail investors typically place is not the same as for institutional market participants. In addition, as discussed in Section V.C.2.a.i., because the information contained in 606(a)(1) reports could be more relevant to retail orders than 606(b)(3) reports, misclassification of orders would limit the benefits that retail customers could receive from the enhanced transparency of the retail order routing reports.

2. Scope of Broker-Dealer's Obligation Under Rule 606(b)(3)

The Commission is adopting the Rule 606(b)(3) requirement that every broker-dealer must, on request of a customer that places, directly or indirectly, one or more orders in NMS stocks that are submitted on a not held basis with the broker-dealer, disclose to such customer a report on its handling of institutional orders for that customer, unless a de minimis exception in Rules 606(b)(4) or (b)(5) applies. In addition, the Commission is maintaining the exclusion of broker-dealers from the current definition of "customer" and that exclusion is maintained for purposes of Rule 606(b)(3), which cross-references the term "customer."

The Commission considered an alternative that would apply the disclosure requirements to broker-dealers that receive not held NMS stock orders from other broker-dealers. Compared

to the adopted Rule 606(b)(3), this alternative could enable customers to receive more comprehensive order handling data, which could improve customers' understanding of execution details of their orders, such as payment for order flow, rebates, and access fees. As some commenters stated, this alternative could help customers make more informed investment decisions.[774] Thus, this alternative could benefit customers by providing them with additional information on their order handling by broker-dealers, so that customers could assess and monitor their broker-dealers' order routing practices, which could promote competition among broker-dealers.

However, this alternative could also increase compliance and reporting costs to broker-dealers. As one commenter stated,[775] to the extent that broker-dealers may outsource order routing technology to other broker-dealers, executing broker-dealers may be required to create individual order handling reports and make their execution data available to customers with whom they have no prior relationship.

Additionally, the competition among broker-dealers could provide incentives for broker-dealers to provide order-handling information to customers regardless of the scope of the reporting requirements. For instance, customers could choose not to send orders on a not held basis to introducing broker-dealers that are unable to provide the information, which could incentivize introducing broker-dealers to request the information from their executing broker-dealers that, in turn, may risk losing introducing broker-dealers as customers unless they provide the information. As one commenter stated, such competitive market forces could motivate

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774 See Dash Letter at 4-5; FIF Letter at 3, 7-8; and SIFMA Letter at 3-4.

775 See Bloomberg Letter at 16.

broker-dealers to provide additional information that could address customers' expectations.[776] Moreover, customers could choose to negotiate with broker-dealers for additional disclosures, such as introducing broker-dealers requesting the information from their executing broker-dealers. With the information, customers could assess whether their broker-dealer is adequately serving its investing and trading expectations, as well as whether they would be better served by utilizing the services of a broker-dealer that is able to provide the full suite of detailed order handling information set forth in Rule 606(b)(3).

3. Public Availability of Aggregated Rule 606(b)(3) Order Handling Information

Proposed Rule 606(c) required public quarterly reports broken down by calendar month on the order routing and execution quality of aggregated institutional orders by each broker-dealer. Under the rule amendments for not held NMS stock orders as adopted, but not as proposed, broker-dealers are required only to provide customer-specific order handling reports required by Rule 606(b)(3), and none of the information set forth in Rule 606(b)(3) is required to be made public.

Prior to and after today's amendments, Rule 606 does not require a broker-dealer to provide public reports for not held NMS stock orders.[777] While an institutional customer or a customer that submits NMS stock orders on a not held basis can request individualized reports from broker-dealers about the handling of its orders, the lack of public reports relating to such orders makes it difficult for a customer to compare handling of such orders by broker-dealers that the customer does not have a business relationship with. Further, for the broker-dealers that

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776 See id.

777 Separately, there are no publicly available reports about the handling of institutional or not held NMS stock orders published by independent researchers and analysts, academic researchers, the public at large, or third-party vendors.

the customer does send orders to, the customer is not able to compare these broker-dealers more generally based on all orders those broker-dealers handle rather than only the orders the customer sends to the broker-dealers.[778]

The Commission considered the proposed Rule 606(c) as an alternative to this adopted rule. Specifically, this alternative would require broker-dealers to publicly report, on a quarterly basis, aggregated Rule 606(b)(3) order handling information. As discussed in Section III.B., several commenters provided critiques of or suggested revisions to the proposed rule regarding the proposed public aggregated order handling reports.[779] The Commission has considered these comments and has revised its analysis of the economic effects of such public aggregated reports since the Proposal.

As discussed in the Proposing Release, proposed Rule 606(c) would provide the benefits of increasing the transparency of order handling and providing additional information to customers beyond that provided by customer-specific reports required by amended Rule 606(b)(3). Customers would be able to compare their broker-dealers not just based on the orders they send to the broker-dealers, but also based on all Rule 606(b)(3) orders handled by the broker-dealers.[780] The aggregated reports would assist customers in facilitating discussions with their broker-dealers about the broker-dealers' handling of their orders. The reports would also allow current and prospective customers to compare broker-dealers' order handling and,

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778 Prior to today's amendments, a customer placing not held NMS stock orders could only compare broker-dealers on the basis of the orders it had sent to the broker-dealers because only those are contained in the ad hoc reports the broker-dealers provide upon request, and the customer cannot compare how its broker-dealers handle the orders it had sent compared to all of the not held NMS stock orders the broker-dealers had received. In addition, the ad hoc reports provided by the broker-dealers upon request by a customer placing not held NMS stock orders may be provided in different formats and contain different and potentially inconsistent information, which makes the comparison of the order routing decisions and execution quality of broker-dealers more difficult and less useful.

779 See Fidelity at 6; Market Letter at 6.

780 See Fidelity at 6.

ultimately, to inform their choice of broker-dealers. For example, the reports could allow customers to compare the execution services of their current broker-dealers with other competitors, who might route orders more often to the venues offering better average execution quality. Moreover, this alternative could promote competition as broker-dealers may seek to differentiate their services and expertise in an effort to retain current customers and attract the business of prospective customers. Further, the public aggregated order handling reports could improve the extent and quality of information available for independent research and analysis by academic researchers, the public at large, or third-party venders, thereby furthering the public monitoring of broker-dealers conflicts of interest and enhancing the benefits of increased transparency.

In light of the comments received and after further consideration, the Commission now believes that the aggregated information in the proposed public report would provide more limited benefits than those described in the Proposal. In particular, the reports might not allow for meaningful insight into the quality of broker-dealers' order routing performance or comparisons of order handling performance across broker-dealers. Moreover, the aggregation required for the reports would dilute the information necessary to compare one customer to a broker-dealer's customers more generally or to compare across broker-dealers.[781]

Further, the Commission does not believe that it could easily design the aggregated reports to limit such dilution without raising the risk of revealing sensitive information of customers that submit not held NMS stock orders, in particular the institutional customers that typically submit such orders. Each customer has a unique set of circumstances, goals, and order flow that dictates how a broker-dealer handles that customer's orders. For example, if a broker-

[781] See supra notes 337-339 and accompanying text.

dealer were to aggregate together the orders of both its quantitative trading firm and mutual fund clients in a single, aggregated public report, the dilutive effect would result in a washing out of the routing nuances that are relevant to each type of customer and that are important to understanding a broker-dealer's routing decisions when granted full discretion.[782]

In addition, not held NMS stock orders from customers frequently limit broker-dealer discretion in some manner, which would reduce the value of the reports in providing information about the broker-dealer's own decisions in order handling. For broker-dealers that do not typically have full discretion on the handling of a not held NMS stock order, an aggregated order handling report could be more of an indication of its client mix and the preferences of its clients than about the broker-dealer's performance.

Even a customer comparing its own individual report to the aggregate report of its own broker-dealer might not be able to realize the potential benefit of making meaningful comparisons without knowing the specific nature, practices, and requests of the broker-dealer's other customers. In theory, a customer could ask its broker-dealers to explain how the customer's report fits into the aggregate report, which could allow the customer to make meaningful comparisons and receive the benefits of additional transparency. However, this would result in additional costs to broker-dealers and customers because the broker-dealers would need to spend their time and resources to provide explanations to their customers regarding how individual reports fit into aggregated information. The greater these costs to the customers, the less likely they would be to use the reports.

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782 If a broker-dealer were not required to aggregate the orders, however, the report might reveal the strategies of each type of customer.

Further, a broker-dealer may not be willing to provide a lengthy explanation of its public aggregated report to an institutional or retail investor that is not its customer, significantly limiting the potential benefit to customers of comparing their broker-dealers to broker-dealers the customer does not have a business relationship with. This may also lead to public analyses and commentary regarding order routing practices that are not informed by any meaningful understanding of the customer types and routing preferences included in aggregate reports.

Even in the absence of public aggregated reports, consultants and providers of TCA for customers – particularly institutional customers – could perform aggregate analysis, but in a much more meaningful and productive way by aggregating the data of customers that submit NMS stock orders on a not held basis with like trading characteristics. Consultants could collect information with the permission of such customers, aggregate the data of customers with like trading characteristics, and provide reports that would be more readily and meaningfully comparable across broker-dealers. Although using consultants might provide comparable reports to customers, it would result in monetary costs to customers in paying for the service of consultants.

In addition to viewing the benefits to public aggregated reports in proposed Rule 606(c) to be somewhat more limited than those in the discussion in the Proposing Release, the Commission believes the aggregated reports would have the potential to result in additional costs for broker-dealers and their customers. In particular, customers could be confused to the extent that an aggregated public report suggests substandard order handling practices even if a broker-dealer is performing very competently. Broker-dealers would be at a disadvantage if the reports did not adequately summarize relevant information about the quality of customer service. Such a misinterpretation of the aggregate report could result in the customer sub-optimally switching

broker-dealers. For example, a customer could use the aggregated public reports to compare its broker-dealer to other broker-dealers and could switch to another broker-dealer. If the new broker-dealer is performing worse than the previous broker-dealer, the customer could get worse order handling treatment. This would also result in costs to the original broker-dealer because of the loss of customers.

Given the Commission's understanding of the limitations of the benefits and the addition of costs per the discussion of the public aggregated reports in the Proposing Release, the Commission believes that customers could alter their behavior in recognition of the limitations of the public report in the long-run if not in the short-run. For example, communications with broker-dealers in explaining how the customer's data fits into the aggregate report could facilitate the customer's learning process, which could help customers potentially achieve some positive benefits from the reports and avoid responding in a manner that results in worse order handling for them. On the other hand, the customers could also manage this cost by deciding not to use the reports at all. Such a response would also result in no benefits from the report. In addition, under this alternative, broker-dealers would incur additional reporting costs because they would need to prepare public reports and disseminate the order routing information to the public regularly. As stated in the Proposing Release,[783] the Commission estimated that the estimated total burden per year for all broker-dealers that route institutional orders to comply with the reporting requirement under the alternative would have been approximately 5,920 hours, resulting in a monetized cost burden of $1,046,640, plus an additional third-party service provider fee of $130,000.[784]

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783 See Proposing Release, supra note 1, at 49491.

784 40 hours per broker-dealer that routes institutional orders who will create the required reports x 135 such broker-dealers + 8 hours per broker-dealer that routes institutional orders who will use a third-party service

4. Automatic Provision of Customer-Specific Not Held Order Handling Report (Adopted Rule 606(b)(3))

The Commission considered an alternative to adopted Rule 606(b)(3) that would not require that customers request customer-specific standardized reports on not held NMS stock order handling, but would instead require broker-dealers to provide them to customers automatically, either by sending the reports out or by providing a portal where customers can view or download the reports. This alternative could reduce the cost to customers, compared to both the baseline and the amendment, of acquiring such order handling reports, because customers would not need to request the reports. At the same time, this alternative may not benefit customers compared to the adopted amendment, as discussed in the Proposing Release.[785] In addition, as one commenter stated,[786] to the extent that some institutional customers may request firm-specific customized reports and may not need the additional information in the order handling report, this alternative may not provide additional benefits compared to the rule as adopted.

With respect to the costs to broker-dealers, the alternative would impose additional initial costs compared to the baseline, as broker-dealers would be required to automatically provide reports to all customers, not just those that request reports, and would have to build infrastructure to generate these reports. The Commission believes, however, that these initial costs likely would be minimal, because the alternative would involve slight modifications to the systems that

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provider to create the required reports itself x 65 such broker-dealers = 5,920 hours. The Commission estimates the total monetized burden for this requirement to be $1,046,640 ($6,840 per broker-dealer that will create the reports itself x 135 such broker-dealers + $1,896 per broker-dealer that uses a third-party service provider to create the required reports x 65 such broker-dealers = $1,046,640). Also, $2,000 per broker-dealer that will use a third-party service provider to prepare its reports x 65 such broker-dealers = $130,000.

785 See Proposing Release, supra note 1, at 49501-02.

786 See Fidelity Letter at 4-5.

produce the required order handling reports. Moreover, as discussed in the Proposing Release, the effect of this alternative on the costs to broker-dealers, compared to the cost of the rule as adopted, is unclear.[787]

5. Submission to the Commission of Not Held NMS Stock Order Handling Reports (Adopted Rule 606(b)(3))

The Commission considered an alternative to adopted Rule 606(b)(3) that would require these customer-specific order handling reports to be submitted to the Commission. With direct access to the reports under this alternative, the Commission could potentially use the reports, to investigate best execution concerns, assist in risk-based examination decisions, and/or conduct market analyses on order handling to promote data-driven rulemaking, which could benefit investors and the market in the form of enhanced investor protection and better informed rulemaking.[788]

While providing some benefits, this alternative would also impose additional costs to broker-dealers to submit their reports to the Commission. Further, the Commission believes that acquiring the reports from each broker-dealer could impose burdens on Commission resources, though the magnitude of those burdens is unknown. Receiving customer-specific order handling reports could impose further costs on the Commission, as the Commission would need to take steps to safeguard personally sensitive information, though it might be able to leverage its experience dealing with the receipt of sensitive information in other contexts to minimize those costs.

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787 See id.

788 See Proposing Release supra note 1, at 49502.

6. Categories of NMS Stocks for Rule 606(a)

The Commission considered an alternative that would partition the report required by Rule 606(a)(1) by both listing markets and S&P 500 index inclusion instead of by S&P 500 index inclusion alone. As discussed in Section V.C.2.e.i., the Commission staff's analysis indicates that partitioning by listing exchange could provide additional information to customers beyond the information contained in reporting by S&P 500 index inclusion. Therefore, this additional partition could allow customers to combine the Rule 606(a)(1) reports with the Rule 605 reports to help investors better judge the effect of broker-dealers' routing decisions on execution quality.

This alternative could result in broker-dealers incurring additional reporting and compliance costs relative to the adopted rule, because broker-dealers would need to change the reporting format to include both S&P 500 index inclusion and listing markets information. Compared to the adopted rule, the benefits of such order reports could be limited to the extent that the Rule 606(a)(1) order reports divided by both listing markets and S&P 500 index are less clear for customers and the public to understand. As discussed in Section V.C.2.e.i., staff analysis showed that S&P 500 index and listing markets have distinct information that is correlated with execution quality. To the extent that customers may not understand the information content of the order reports divided by both listing markets and S&P 500 index, customers would not be able to better assess the order routing and execution quality under this alternative, which, in turn, could make it less efficient for the customers to evaluate and select broker-dealers.

7. Disclosure of Additional Information about Not Held NMS Stock Order Routing and Execution

The Commission considered requiring additional measures to be included in adopted Rule 606(b)(3) reports for orders submitted on a not held basis. In particular, the Commission considered an alternative that would categorize orders by routing strategy in the reports and an alternative to report additional execution quality statistics.

Currently, as such order handling reports are not standardized and vary by broker-dealer or by customer, the Commission understands that some of these reports group order routing strategies by their aggressiveness, while other reports do not. Rule 606(b)(3) does not require the order handling report to be categorized by order routing strategy for each venue to which the broker-dealer routed the customer's orders submitted on a not held basis.

The Commission considered the proposed categorization as an alternative to the adopted rule. Under the alternative, order routing strategies for such orders would be categorized into three general strategy categories: (1) a "passive order routing strategy," which emphasizes the minimization of price impact over the speed of execution of the entire order; (2) a "neutral order routing strategy," which is relatively neutral between the minimization of price impact and speed of execution of the entire order; and (3) an "aggressive order routing strategy," which emphasizes speed of execution of the entire order over the minimization of price impact.

This alternative could facilitate comparisons among broker-dealers by customers placing not held NMS stock orders because it would allow customers to control for the fact that broker-dealers may get different types of order flow. For example, to satisfy customer order instructions one broker-dealer may tend to use an aggressive order routing strategy and another broker-dealer may tend to use a passive order routing strategy, and simply comparing these two broker-dealers

without considering the order routing strategy category may lead to incorrect or misleading conclusions.

Customers preferring passive order routing strategies may be willing to wait longer for an execution but may want to limit price impact. Customers preferring aggressive order routing strategies, however, may endure some price impact to trade quickly. Therefore, a broker-dealer implementing a passive order routing strategy may, compared to an aggressive order routing strategy, tend to route to a dark pool where execution may be less certain, but likely at a better price.[789] Similarly, a broker-dealer implementing passive order routing strategies may be able to place orders providing liquidity more often, thereby capturing more rebates.[790] As a result, the routing statistics of a broker-dealer that implements predominantly passive order routing strategies should differ from those of a broker-dealer that implements predominantly aggressive order routing strategies. Therefore, including the categories of order routing strategies in the order handling report can facilitate an assessment of how well a broker-dealer manages its conflicts of interest and provides execution quality that matches customer preferences because it provides information on the preferences communicated by that broker-dealers' customers.

The alternative to differentiate the adopted disclosures into the three order routing strategy categories could help mitigate the possibility that the reports could be interpreted incorrectly. However, there could still be differences among broker-dealers in how they

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789 See, e.g., Albert J. Menkveld, Bart Zhou Yueshen, and Haoxiang Zhu, Shades of Darkness: A Pecking Order of Trading Venues, 124 Journal of Financial Economics, (2017). The authors find that there exists a pecking order of trading venues that puts low-cost-low-immediacy venues on top and high-cost-high-immediacy venues at the bottom. This suggests that if an order is a passive order and executed with passive order routing strategy, the broker- dealer would prefer low-cost-low-immediacy venues, which the paper identifies as dark pools that execute at the midpoint.

790 Compared to an aggressive order routing strategy, a passive order routing strategy may reduce transaction costs and allow the capture of rebates, but immediate execution is not certain. See Lawrence Harris and Joel Hasbrouck, Market vs. Limit Orders: The SuperDOT Evidence on Order Submission Strategy, 31 Journal of Financial and Quantitative Analysis 213, 230 (1996).

classify orders into the three strategy categories, which could make straight comparisons between broker-dealers difficult.

This alternative could also create unnecessary subjectivity, as broker-dealers may categorize similar routing strategies differently, which could limit the utility and comparability of the reports. Moreover, as several commenters stated,[791] trading algorithms these days may use multi-layered methodologies that would fit into more than one of the adopted categories, which makes categorizing orders into three types too simplistic to adjust to changing market conditions or to reflect complex routing strategies. For these reasons, the Commission believes dividing order routing strategies into a fixed number of order routing categories would not provide a useful basis for comparison.

Moreover, this alternative could result in higher implementation costs relative to adopted Rule 606(b)(3), by requiring differentiating order routing strategies for not held NMS stock orders into three types. The Commission believes that broker-dealers would incur costs associated with creating their methodologies, assigning each order routing strategy for such orders into one of these three categories according to the methodologies, and promptly updating the assignments any time an existing strategy is amended or a new strategy is created.

Furthermore, as adopted, customers remain able to negotiate with their broker-dealers for additional disclosures or categorizations that could address their interests better, such as categorizations by routing strategy. With this information, institutional customers could obtain information to evaluate and monitor their broker-dealers performance in order routing.

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[791] See, e.g., Better Markets Letter at 5; Capital Group Letter at 5; Fidelity Letter at 5; FIF Letter at 4; ICI Letter at 8; Markit Letter at 2, 20-21; MFA Letter at 4; KCG Letter at 6-7; SIFMA Letter at 4.

The Commission considered another alternative that would require Rule 606(b)(3) reports to contain additional execution quality measures, such as realized spread and effective spread, price improvement statistics, the percentages of effective spreads and quoted spread percentages, time to execution, or implementation shortfall, which represent varying dimensions of execution quality. As several commenters stated, adding these statistics would increase the information content and the usefulness of the reports relative to Rule 606(b)(3), and would provide execution quality statistics that would reflect changes in market structure.[792] Additionally, relative to the execution quality measures under adopted Rule 606(b)(3), this alternative would enable customers to use different execution quality statistics that are more informative for their needs.

This alternative could result in higher implementation costs relative to adopted Rule 606(b)(3) by requiring additional execution quality statistics in the report. In addition, for some execution quality metrics, the computation costs would be larger than for others. Furthermore, as raised by a number of commenters,[793] the volume disclosures could overwhelm retail and some institutional customers that would therefore not benefit from additional information on execution quality statistics. To the extent that customers are not familiar with certain execution quality metrics, additional execution quality measures more than required by the adopted rule may not be useful to investors to better compare broker-dealers and may not promote competition among broker-dealers along the execution quality dimensions provided in the reports.

Furthermore, if customers wish to obtain additional information on execution quality, customers could negotiate for additional execution quality statistics with their broker-dealers that

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792 See, e.g., Angel Letter at 5; Better Markets Letter at 5-8; Capital Group Letter at 6; FSR Letter at 5-6; HMA Letter at 10; ICI Letter at 9; Markit Letter at 9-10; and Schwab Letter at 2.

793 See, e.g., STA Letter at 3.

could address customers' interests better. By doing so, customers could obtain relevant information to evaluate their broker-dealers performance in order routing.

8. Order Handling Reports at the Stock Level (Adopted Rule 606(b)(3))

The Commission considered requiring the order handling information required by Rule 606(b)(3) to be reported at the individual stock level rather than aggregated across stocks. This alternative would enhance transparency to customers relative to Rule 606(b)(3) because the reports would be more detailed as discussed in the Proposing Release.[794] Specifically, as one commenter stated, reporting at the individual stock level could provide additional information that reflects stock liquidity or market conditions that may affect broker-dealers' order routing decisions, which could enable customers to better assess their broker-dealers.[795]

Because the reports would be more detailed, however, this alternative would increase the costs of producing the reports, as well as the costs of using the reports relative to Rule 606(b)(3). However, as discussed in the Proposing Release, the Commission believes that any potential increase in costs of producing the reports would be negligible.[796]

9. Alternative to Three-Year Posting Period (Adopted Amendments to Rules 605(a)(2) and 606(a)(1))

The Commission considered requiring broker-dealers and market centers to make the reports required by Rule 605(a) and 606(a)(1) available for a minimum length of time of less than three years or more than three years. If public reports are available for less than three years, then historical data might not be as readily available to customers and the public who are seeking to analyze past routing behavior of broker-dealers or past execution quality of market centers, as

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794 See Proposing Release supra note 1, at 49503-04.

795 See Capital Group Letter at 5.

796 See Proposing Release supra note 1, at 49504.

it would be under the adoption of a three-year posting period. Customers and the public would either have to download the data more often or have to rely on third-party vendors who download and aggregate the data. Compared to the adopted three-year posting period, this alternative would reduce the execution quality of market centers and the transparency of broker-dealer routing decisions for customers placing orders covered by the reports required by Rule 605(a) and 606(a)(1). A shorter minimum length of time would reduce the costs broker-dealers incur associated with posting reports relative to a three-year posting period. However, as discussed above, the Commission believes these incremental costs to be small and that the cost savings associated with a shorter minimum length of time would not justify the costs of historical data potentially being less readily available to customers and the public.

If public reports are available for more than three years, the historical data would be even more readily available to customers and the public who are seeking to analyze past routing behavior of broker-dealers or past execution quality of market centers than it would be under a three-year posting period. Customers and the public would have to download the data less frequently to have access to historical data that is older than three years. However, the Commission believes that the additional benefit of a minimum length of time of more than three years would be small because three years is a meaningful time period considering the rapid changes in financial markets and customers, and the public would only need to download data every three years to be able to access historical data older than three years. While some commenters stated similar benefits of keeping public reports for more than three years as discussed above, commenters also stated the out-of-date information may lead to misleading analysis of past routing behavior of broker-dealers or past execution quality of market centers.[797]

[797] See Citadel Letter at 1; FIF Letter at 13; Markit Letter at 29.

As a result, keeping public records for an extended period compared to the adopted rule would not provide additional benefits to customers. The Commission also understands that maintaining public reports for more than three years may represent a burden and result in an additional cost to broker-dealers. However, as discussed above, the Commission believes the additional cost to be small.

E. Economic Effects and Effects on Efficiency, Competition, and Capital Formation

Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the anti-competitive effects of any rules it adopts.[798] Specifically, Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that will impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[799] Furthermore, Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[800] We consider these effects below.

1. Effects of Adopting Amendments on Efficiency and Competition

a. Amendments to Public Disclosures for Orders Covered By Rule 606(a) and 606(b)(1)

The adopted amendments to Rule 606(a)(1) require broker-dealers that route non-directed orders in NMS stocks submitted on a held basis and non-directed orders that are customer orders in NMS securities that are options contracts to make public enhanced aggregated reports

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798 15 U.S.C. 78c(f).

799 See id.

800 15 U.S.C. 78w(a)(2).

regarding such orders detailing order routing practices and information regarding marketable and non-marketable limit orders in addition to information on payment for order flow arrangements, payment from any profit-sharing relationship received, and transaction fees paid and rebates received per share and in aggregate for such orders. In addition, the adopted amendments to Rules 606(a)(1) require those reports to be made available using an XML schema and associated PDF renderer on the Commission's website. Finally, the adopted amendment to Rule 606(a)(1) requires the public reports to be maintained on a website that is free and readily accessible to the public for a period of 3 years.[801]

As explained in detail below, the Commission believes that the enhanced disclosures for orders covered by Rule 606(a)(1), which require broker-dealers to describe any terms of payment for order flow arrangements and profit-sharing relationships with Specified Venues that may influence their order routing decisions for such orders, should promote competition and enhance efficiency.

First, per the discussion above, the additional information required by the amendments relative to the information required by Rule 606(a)(1) will allow customers to better assess the order routing and execution quality provided by their broker-dealers,[802] which, in turn, will

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801 Consistent with the adopted amendments to Rule 606, the Commission is adopting amendments to Rule 605(a)(2) to require market centers to keep public execution reports required by the rule posted on an website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website. The Commission believes that making past order execution information available to customers and the public generally will be useful to those seeking to analyze historical order execution information from different market centers. The adopted requirement to keep public execution reports required by Rule 605 for a period of three years is expected to make it easier, and thus more efficient, for the public to collect historical data for analysis. The Commission believes the adopted requirement could enhance efficiency in the data collection process of those seeking to retrieve and analyze historical order execution information from different market centers.

802 See supra Section 0.C.2.

enable the customers to more efficiently evaluate and select broker-dealers.[803] The adopted amendments to Rule 606(a) will require broker-dealers, for orders covered by Rule 606(a)(1), to differentiate between marketable and non-marketable limit orders and to publicly report the net aggregate amount of any payment for order flow, payment from any profit-sharing relationship received, the transaction fees paid, and transaction rebates received, both as a total dollar amount and on a per share basis, for each of the following order types: market orders, marketable limit orders, non-marketable limit orders, and other orders. As discussed in Sections V.C.2.b. through d., the Commission believes that this will allow customers and the public to better understand the potential conflicts of interest broker-dealers may face when routing such orders and to assess if and how well broker-dealers manage these potential conflicts of interest. This will enable customers to make a more informed decision as to which broker-dealers to use for such orders. The Commission believes that this will enhance the competition for such order flow between broker-dealers, which could improve order routing services and execution quality. Customers could use additional information to evaluate and retain the services of a broker-dealer or to discontinue the use of such services, and broker-dealers may use the information required by the adopted amendments to Rule 606(a) as a means to evaluate and enhance their order routing and execution services, to compare their order routing and execution services to those of other firms, and to use such comparison in selling their services to customers. As a result, the Commission

[803] The adopted amendments to Rule 606(a)(1), which will no longer require reports to be divided into separate sections for stocks listed on different exchanges, may be an exception to this. As discussed below, to the extent that order routing decisions may differ for stocks that are listed on different exchanges, the reports that aggregate the data as required by the adopted amendments to Rule 606(a)(1) may provide less information to retail customers and the public and therefore may reduce the efficiency with which customers and the public are able to evaluate and select broker-dealers on the basis of the order routing and execution quality they provide.

believes that competition between broker-dealers could provide better execution quality for such orders.

In addition, if broker-dealers change their routing behavior in response to the public reports required by adopted amendments to Rule 606(a)(1), the Commission believes that competition between trading centers might be enhanced as trading centers could better compete for such order flow, which might result in better execution quality for such orders and innovation by existing or new trading centers. As discussed in Section V.C.1.b.i.1., one way a trading center can attract order flow is through innovation, thereby differentiating itself from other trading centers.

Further, to the extent that the adopted amendments to Rule 606(a) lead to better execution quality provided by broker-dealers and trading centers, the Commission believes that the adopted amendments will lead to lower transaction costs for customers. Because transaction costs can be viewed as a measure for efficiency in the trading process, lower transaction costs would indicate enhanced efficiency in the trading process. In addition, to the extent that the adopted amendments to Rule 606(a) make the trading process more efficient by lowering trading costs, the Commission believes the adopted amendments will reduce market friction and therefore have a positive effect on the efficiency of prices.

As discussed above, however, the adopted amendments to Rule 606(a)(1) could result in costs that may have an effect on efficiency and competition. For example, the adopted amendments will impose certain costs on broker-dealers that currently route orders covered by Rule 606(a)(1) as well as on broker-dealers that would like to start routing such orders and will also have to comply with the adopted amendments to Rule 606(a)(1). To the extent that the costs for a broker-dealer entering the market for such orders are higher following the amendments to

Rule 606(a)(1), these higher costs could lead to a higher barrier to entry and thereby reduce competition. However, the Commission believes that any difference in costs under amended Rule 606(a)(1) would be relatively small and, alone, would not deter broker-dealers from entering the market for routing such orders.

Under the adopted amendments to Rule 606(a)(1), the broker-dealer may be concerned about the perception of acting on a conflict of interest. As a result, a broker-dealer may be incentivized to route fewer non-marketable limit orders to the trading center offering the highest rebate, even if this negatively affects execution quality, in an effort to ensure that a customer does not misconstrue the intent behind the broker-dealer's routing decisions. Such a potential outcome could reduce to some degree the intensity of competition between broker-dealers on the dimension of execution quality. However, the Commission believes that such a scenario is not likely as customers are likely to review the 606(a)(1) reports in conjunction with execution quality statistics currently required pursuant to Rule 605 and can discuss with their broker-dealers the order routing and execution quality the broker-dealer provides.

b. Amendments to Disclosures for Orders Covered By 606(b)(1)

The adopted amendments to Rule 606(b)(1) require a broker-dealer, upon customer request, to provide the disclosures set forth in Rule 606(b)(1) for orders in NMS stock that are submitted on a held basis, and for orders in NMS stock that are submitted on a not held basis and for which the broker-dealer is not required to provide the customer a report under Rule 606(b)(3). In addition, the adopted amendments to 606(b)(1) require those reports to be made available using an XML schema and associated PDF renderer on the Commission's website.

The Commission believes that the adopted amendments to Rule 606(b)(1), which require broker-dealers to provide, upon customer request, information relating to orders not covered by Rule 606(b)(3), should promote competition and enhance efficiency. As discussed in Section

III.A.1.b.vi., Rule 606(b)(1) disclosures will allow customers to better assess the order routing and execution quality provided by their broker-dealers, which, in turn, will enable the customers to more efficiently evaluate and select broker-dealers. If requested, these disclosures provide the customer with information as to the venues to which its orders were routed, whether the orders were directed or non-directed, and the time of any transactions that resulted from the orders. Rule 606(b)(1) cover held NMS stock orders and should provide customers that submit NMS stock orders on a held basis with disclosures designed to provide more transparency into potential financial inducements and potential conflicts of interest faced by broker-dealers. The Commission believes that these disclosures provide information that is sufficient to provide a basis for the customer to engage in further discussions with its broker-dealer regarding the broker-dealer's order handling practices, should the customer so choose. As a result, the Commission believes that competition between broker-dealers could provide better execution quality for orders covered by Rule 606(b)(1).

In addition, if broker-dealers change their routing behavior in response the customer-specific reports required by the adopted amendment to Rule 606(b)(1), the Commission believes that competition between trading centers might be enhanced as trading centers could better compete for such order flow, which might result in better execution quality for such orders and innovation by existing or new trading centers. As discussed in Section V.C.1.b.i.1., one way a trading center can attract order flow is through innovation, thereby differentiating itself from other trading centers.

The Commission also believes that the adopted amendment to Rule 606(b)(1) will provide additional benefits of better execution quality and reduced transaction costs, but acknowledges that these benefits are attainable only when customers request 606(b)(1) reports.

To the extent that customers actually request Rule 606(b)(1) reports and the adopted amendments to Rule 606(b)(1) lead to better execution quality provided by broker-dealers and trading centers, the Commission believes that the adopted amendments will lead to lower transaction costs for customers. Because transaction costs can be viewed as a measure for efficiency in the trading process, lower transaction costs would indicate enhanced efficiency in the trading process. In addition, to the extent that the adopted amendments to Rule 606(b)(1) make the trading process more efficient by lowering trading costs, the Commission believes the adopted amendments will reduce market friction and therefore have a positive effect on the efficiency of prices.

As discussed above, however, the adopted amendments to Rule 606(b)(1) could result in costs that may have an effect on efficiency and competition. For example, the adopted amendments will impose certain costs on broker-dealers that currently route orders covered by Rule 606(b)(1), as well as on broker-dealers that would like to start routing such orders and will also have to comply with the adopted amendments to Rule 606(b)(1). To the extent that the costs for a broker-dealer entering the market for such orders are higher following the amendments to Rule 606(b)(1), these higher costs could lead to a higher barrier to entry and thereby reduce competition. However, the Commission believes that any difference in costs under amended Rule 606(b)(1) would be relatively small and, alone, would not deter broker-dealers from entering the market for routing such orders.

c. Adopted Rules for Disclosures for Not Held NMS Stock Orders

For NMS stock orders submitted on a not held basis, Rule 606(b)(3), as adopted, will require broker-dealers that route such orders to provide detailed reports to customers that submit such orders upon the request of the customer, unless such broker-dealer is excepted from this requirement as provided in new Rules 606(b)(4) and (b)(5). In addition, these rules will require

reports on such orders to be provided using an XML schema and associated PDF renderer published on the Commission's website. As discussed below, the Commission believes that these disclosures of order routing decisions by broker-dealers for such orders could promote competition and enhance efficiency.

First, the disclosures required by Rule 606(b)(3) will inform customers as to the order routing practices of and the execution quality provided by a particular broker-dealer, as described in further detail above. As a result, customers will be able to use that information to compare the order routing and execution quality of their broker-dealers, on the basis of the orders submitted to those broker-dealers as reported in the customer-specific reports required by Rule 606(b)(3).

These enhanced disclosures will better enable customers to analyze order routing and execution quality provided by broker-dealers, which will allow customers to more efficiently monitor, evaluate, and select broker-dealers. In addition, customers and broker-dealers will be able to evaluate execution quality of orders covered by Rule 606(b)(3) on different trading centers more efficiently.[804] Customers also will be better informed as to the order routing and execution quality they received from a particular broker-dealer. If a customer feels it received poor order routing and execution quality from a particular broker-dealer, the customer could initiate a dialogue with the broker-dealer for an explanation, which may lead to better order routing decisions and execution quality by the broker-dealer. The customer may also decide to use different broker-dealers in order to seek better order routing and execution quality. This could enhance competition between broker-dealers.

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[804] See supra Section 0.C.0.

Further, the Commission believes that Rule 606(b)(3), as adopted, might enhance competition between trading centers. First, if broker-dealers change their routing decisions in response to the reports required by Rule 606(b)(3), trading centers will have an additional incentive to compete for order flow covered by Rule 606(b)(3). Second, the reports required by Rule 606(b)(3) are structured by trading center, so that the execution quality at each trading center would be clearly visible. This may lead broker-dealers to change their routing behavior, but also, more directly, customers could compare the execution quality of all trading centers, which may again lead to enhanced competition among trading centers. The Commission believes that the enhanced competition between trading centers could lead to innovation by existing and new trading centers, resulting in better execution quality for customers placing orders covered by Rule 606(b)(3). As discussed in Sections V.C.2.b.i., V.C.2.c.i., and V.C.2.d.i., if a trading center were to lose order flow to other trading centers because of lower execution quality, it would have the incentive to innovate to improve its execution quality.

To the extent that Rule 606(b)(3) leads to broker-dealers and trading centers providing better execution quality, the Commission believes that the rule might lead to lower transaction costs for orders covered by Rule 606(b)(3). As discussed above, lower transaction costs indicate enhanced efficiency in the trading process, and the Commission believes that, as a result, the adopting rules will reduce market friction and therefore have a positive effect on the efficiency of prices.

In addition, the Commission believes that the requirement of standardized customer-specific order handling reports in Rule 606(b)(3) will enhance efficiency for customers in processing the information contained in the reports, as compared to the ad hoc reports customers

may currently receive from their broker-dealers.[805] Because the data will be presented in a standardized format, customers will be able to more efficiently aggregate, compare, and analyze the data than they could before adoption of this rule.

In addition, as discussed above, the Commission understands that not held NMS stock orders are typically submitted by institutional customers and many broker-dealers that handle institutional orders currently voluntarily provide reports to institutional customers upon request. However, the Commission understands that how willing a broker-dealer is to provide such reports and the level of detail in the reports might depend on the size of an institutional customer. To that extent, larger institutional customers have an advantage over smaller institutional customers. Rule 606(b)(3), as adopted, will provide access to reports on order handling to all customers, regardless of their size, unless an exception in Rules 606(b)(4) or (b)(5) applies.

The Commission notes that, even without the adoption of Rule 606(b)(3), institutional and other customers could still request customized reports from their broker-dealers and broker-dealers would have an incentive to provide such reports in order to attract order flow. As is currently the case, broker-dealers might be more willing to provide such customized reports to larger institutional customers and the customized reports might provide more detailed information for larger institutional customers. While the Commission believes that Rule 606(b)(3), as adopted, mitigates the advantage of larger institutional customers in that respect, the Commission believes that larger institutional customers are likely to continue to have an advantage over smaller institutional customers to the extent that they are able to obtain customized reports more easily and that those customized reports contain information not

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805 See supra Section 0.0.0. for a discussion of the ad hoc reports and Section 0.0.0. for a discussion of the standardization and format for the reports required by adopted Rules 606(b)(3).

contained in the reports required by Rule 606(b)(3). The Commission believes that by reducing the informational advantage of larger institutional customers over smaller institutional customers, Rule 606(b)(3), as adopted, will improve information asymmetries between larger institutional customers and smaller investors will have more information than before regarding broker-dealers' routing behavior. Smaller institutional customers will be able to evaluate and select their broker-dealers with more efficiency, thereby increasing the efficiency of their investment process. The Commission believes that this will provide smaller institutional customers with information to select the broker-dealers that promote better execution quality, to the benefit of their investors.

As discussed above, however, Rule 606(b)(3) could result in certain costs to broker-dealers that currently route orders covered by Rule 606(b)(3), as well as those who would like to start routing such orders and thus will have to comply with Rule 606(b)(3). These costs could lead to a higher barrier to entry and thereby reduce competition.

However, the Commission believes that the costs associated with Rule 606(b)(3) are not large enough to meaningfully affect the barriers to entry and the level of competition due to potential new entrants into the market for such orders. In addition, the Commission believes that any negative effect on competition due to heightened barriers to entry are justified by the expected positive effect on competition of the disclosures required by Rule 606(b)(3).

In addition, the adoption of Rule 606(b)(3) may cause broker-dealers to change how they handle orders covered by Rule 606(b)(3) because customers' preferences could be skewed toward the metrics as opposed to their true objectives, which could skew broker-dealer incentives, potentially limiting the efficiency and competition benefits of the adopted amendments. First, given that broker-dealers will be aware of the metrics to be used a priori,

they may handle such orders in a manner that promotes a positive reflection on their respective services but that may be suboptimal for customers.[806] Second, the order routing decisions that are indeed optimal for customers could also be viewed as suboptimal for the customers as reflected in the reports required by Rule 606(b)(3).

For example, suppose a broker-dealer routes orders covered by Rule 606(b)(3) so that the orders execute at lower cost with a higher fill rate, shorter duration, and more price improvement than the broker-dealer's competitors. However, it could be the case that, in order to achieve these objectives, the broker-dealer routes the majority of non-marketable limit order shares to the trading center offering the highest rebate. A customer that reviews the adopted order handling reports might suspect that the broker-dealer acted in its self-interest by selecting the highest rebate venue in order to maximize rebates when, in fact, the broker-dealer made the decision on the basis of factors that might not be completely reflected in the adopted reports.[807]

2. Effects of Adopting Amendments on Capital Formation

The Commission believes that the amendments to Rules 600, 605, and 606, as adopted, might have positive effects on capital formation, but predicting the magnitude of such effects is difficult, as the effects likely will be indirect rather than a direct result of the adopted amendments.

As discussed, the Commission believes the adopted amendments to Rules 600, 605, and 606 will enhance competition among broker-dealers and trading centers resulting in better execution quality for customers that place both held or not held NMS stock orders and, to the

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806 The Commission believes that the set of metrics provide customers with a more cost effective view of broker-dealer order handling practices, but recognizes a risk that the information from the disclosures may not perfectly align routing practices and execution quality.

807 See id.

extent that better execution quality will lead to lower friction in the trading process, the adopted amendments will increase market efficiency in both the trading process and asset pricing. This could lead to more efficient asset allocation because better execution quality and greater market efficiency lead to more efficient investment decisions by customers that place orders with broker-dealers.[808] For example, lower transaction costs could allow investors to rebalance their portfolios more frequently and more efficiently and at more efficient prices that better reflect the true underlying value. More efficient asset allocation could have a positive impact on capital formation as capital is allocated to firms with the most profitable projects, which ultimately will allow these firms to raise capital more easily.[809]

Another potential effect on capital formation could derive from the relation between and liquidity and cost of capital. In particular, the less liquid an asset is, e.g., the higher transaction costs are to buy or sell it, the higher the rate of return customers could demand as compensation.[810] For example, lower transaction costs for stocks could result in lower required rates of return for stocks. This in turn could lead to lower cost of capital for the firms, which could have a positive impact on capital formation because it will allow firms to raise capital at more favorable conditions. As noted above, the amendments might improve execution quality for some investors, which is akin to an improvement in liquidity and lower transaction costs. If these improvements are significant enough, issuers could experience a lower cost of capital, resulting in a positive impact on capital formation.

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808 Efficient investment allows capital to be allocated to firms with the most profitable projects, which ultimately will allow these firms to raise capital more easily. On the other hand, less efficient investment could result in funding being available for unprofitable projects, which erode capital.

809 See supra Section 0.0.9. for a discussion of how asset allocation can relate to capital formation.

810 See Yakov Amihud and Haim Mendelson, Asset Pricing and the Bid-Ask Spread, 17 Journal of Financial Economics 223 (1986).

VI. Regulatory Flexibility Certification

The Regulatory Flexibility Act ("RFA")[811] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)[812] of the Administrative Procedure Act,[813] as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on "small entities."[814] Section 605(b) of the RFA states that this requirement shall not apply to any proposed rule or proposed rule amendment, which if adopted, would not have significant economic impact on a substantial number of small entities.

For purposes of Commission rulemaking in connection with the RFA[815] as it relates to broker-dealers, a small entity includes a broker-dealer that: (1) had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,[816] or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization.[817]

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811 5 U.S.C. 601 et seq.

812 5 U.S.C. 603(a).

813 5 U.S.C. 551 et seq.

814 Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term "small entity" for purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10. See Securities Exchange Act Release No. 18452 (January 28, 1982), 47 FR 5215 (February 4, 1982) (File No. S7-879).

815 See id.

816 17 CFR 240.17a-5(d).

817 See 17 CFR 240.0-10(c).

The amendments to Rule 606 are discussed in detail in Sections II and III above. We discuss the economic impact, including the estimated compliance costs and burdens, of the amendments in Section IV (Paperwork Reduction Act) and Section V (Economic Analysis) and above. Based on the Commission's analysis of existing information relating to broker-dealers that would be subject to the amendments to Rule 606, the Commission believes that such broker-dealers do not fall within the definition of "small entity," as defined above.[818] Further, the amendments to Rule 605 to require reports to remain posted on a website for a specified period of time will not have a significant impact on any small entities affected by the Rule because the market centers to which Rule 605 applies do not fall within the definition of "small entity," as defined above.[819] The Commission received no comments regarding its initial Regulatory Flexibility Analysis.[820] For the foregoing reasons, the Commission certifies that the amendments to Rules 600, 605, and 606 will not have a significant economic impact on a substantial number of small entities for the purposes of the RFA.

VII. Statutory Authority and Text of the Proposed Rule Amendments

Pursuant to the Exchange Act, and particularly Sections 3(b), 5, 6, 11A, 15, 17, and 23(a) thereof, 15 U.S.C. 78c, 78e, 78f, 78k-1, 78o, 78q, and 78w(a), the Commission is amending Sections 240.3a51-1, 240.13h-1, 242.105, 242.201, 242.204, 242.600, 242.602, 242.605, 242.606, 242.611, and 242.1000 of chapter II of title 17 of the Code of Federal Regulations in the manner set forth below.

List of Subjects

17 CFR Part 240

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818 The Commission considered FOCUS Report data in making this determination.

819 See supra Section 0.0.0.

820 See Proposing Release, supra note 1, at 59508.

Brokers, Dealers, Registration, Securities.

17 CFR Part 242

Brokers, Reporting and recordkeeping requirements, Securities.

For the reasons stated in the preamble, the Commission is amending title 17, chapter II of the Code of Federal Regulations as follows:

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78*o*, 78*o*-4, 78*o*-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; Pub. L. 111-203, 939A, 124 Stat. 1887, (2010); and secs. 503 and 602, Pub. L. 112-106, 126 Stat. 326 (2012), unless otherwise noted.

* * * * *

§ 240.3a51-1 [Amended]

2. In § 240.3a51-1, paragraph (a) introductory text is amended by removing the text "§ 242.600(b)(47)" and adding in its place "§ 242.600(b)(48)".

§ 240.13h-1 [Amended]

3. In § 240.13h-1, paragraph (a)(5) is amended by removing the text "Section 242.600(b)(46)" and adding in its place "§ 242.600(b)(47)".

PART 242 – REGULATIONS M, SHO, ATS, AC, NMS AND SBSR AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES

4. The authority citation for part 242 continues to read as follows:

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k-1(c), 78l, 78m, 78n, 78*o*(b), 78*o*(c), 78*o*(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd-1, 78mm, 80a-23, 80a-29, and 80a-37.

§ 242.105 [Amended]

5. Section 242.105 is amended:

a. In paragraph (b)(1)(i)(C) by removing the text "§242.600(b)(22)" and adding in its place "§242.600(b)(23)".

b. In paragraph (b)(1)(ii) by removing the text "§242.600(b)(64)" and adding in its place "§242.600(b)(68)".

§ 242.201 [Amended]

6. Section 242.201 is amended:

a. In paragraph (a)(1) by removing the text "§242.600(b)(47)" and adding in its place "§242.600(b)(48)".

b. In paragraph (a)(2) by removing the text "§242.600(b)(22)" and adding in its place "§242.600(b)(23)".

c. In paragraph (a)(4) by removing the text "§242.600(b)(42)" and adding in its place "§242.600(b)(43)".

d. In paragraph (a)(5) by removing the text "§242.600(b)(49)" and adding in its place "§242.600(b)(51)".

e. In paragraph (a)(6) by removing the text "§242.600(b)(55)" and adding in its place "§242.600(b)(59)".

f. In paragraph (a)(7) by removing the text "§242.600(b)(64)" and adding in its place "§242.600(b)(68)".

g. In paragraph (a)(9) by removing the text "§242.600(b)(78)" and adding in its place "§242.600(b)(82)".

§ 242.204 [Amended]

7. In § 242.204, paragraph (g)(2) is amended by removing the text "Rule 600(b)(64) of Regulation NMS (17 CFR 242.600(b)(64))" and adding in its place "§ 600(b)(68) of Regulation NMS (17 CFR 242.600(b)(68))".

8. Section 242.600 is amended by:

a. Redesignating paragraphs (b)(52) through (83) as paragraphs (b)(56) through (87);

b. Redesignating paragraphs (b)(49) through (51) as paragraphs (b)(51) through (53);

c. Adding new paragraphs (b)(50), (54), and (55);

d. Redesignating paragraphs (b)(1) through (48) as paragraphs (b)(2) through (b)(49);

e. Adding new paragraph (b)(1).

f. Amending newly redesignated paragraph (b)(5)(i) by removing the text "paragraph (b)(3)" and adding in its place "paragraph (b)(4)"; and

g. Revising newly redesignated paragraphs (b)(20) and (49).

The additions and revisions read as follows:

§242.600 NMS security designation and definitions.

* * * * *

(b) * * *

(1) *Actionable indication of interest* means any indication of interest that explicitly or implicitly conveys all of the following information with respect to any order available at the venue sending the indication of interest:

(i) Symbol;

(ii) Side (buy or sell);

(iii) A price that is equal to or better than the national best bid for buy orders and the national best offer for sell orders; and

(iv) A size that is at least equal to one round lot.

* * * * *

(20) *Directed order* means an order from a customer that the customer specifically instructed the broker or dealer to route to a particular venue for execution.

* * * * *

(49) *Non-directed order* means any order from a customer other than a directed order.

* * * * *

(50) *Non-marketable limit order* means any limit order other than a marketable limit order.

* * * * *

(54) *Orders providing liquidity* means orders that were executed against after resting at a trading center.

(55) *Orders removing liquidity* means orders that executed against resting trading interest at a trading center.

* * * * *

§ 242.602 [Amended]

9. Section 242.602 is amended:

a. In paragraph (a)(5)(i) by removing the text "§242.600(b)(73)" and adding in its place "§242.600(b)(77)"; and

b. In paragraph (a)(5)(ii) by removing the text "§242.600(b)(73)" and adding in its place "§242.600(b)(77)".

10. Section 242.605 is amended by removing the preliminary note, adding introductory text, and adding a sentence at the end of paragraph (a)(2).

The additions read as follows:

§242.605 Disclosure of order execution information.

This section requires market centers to make available standardized, monthly reports of statistical information concerning their order executions. This information is presented in accordance with uniform standards that are based on broad assumptions about order execution and routing practices. The information will provide a starting point to promote visibility and competition on the part of market centers and broker-dealers, particularly on the factors of execution price and speed. The disclosures required by this section do not encompass all of the factors that may be important to investors in evaluating the order routing services of a broker-dealer. In addition, any particular market center's statistics will encompass varying types of orders routed by different broker-dealers on behalf of customers with a wide range of objectives. Accordingly, the statistical information required by this section alone does not create a reliable basis to address whether any particular broker-dealer failed to obtain the most favorable terms reasonably available under the circumstances for customer orders.

(a) * * *

(2) * * * Every market center shall keep such reports posted on an Internet Web site that is free and readily accessible to the public for a period of three years from the initial date of posting on the Internet Web site.

* * * * *

11. Section 242.606 is amended by revising paragraphs (a) and (b) to read as follows:

§242.606 – Disclosure of order routing information.

(a) *Quarterly report on order routing*. (1) Every broker or dealer shall make publicly available for each calendar quarter a report on its routing of non-directed orders in NMS stocks that are submitted on a held basis and of non-directed orders that are customer orders in NMS securities that are option contracts during that quarter broken down by calendar month and keep such report posted on an Internet Web site that is free and readily accessible to the public for a period of three years from the initial date of posting on the Internet Web site. Such report shall include a section for NMS stocks — separated by securities that are included in the S&P 500 Index as of the first day of that quarter and other NMS stocks — and a separate section for NMS securities that are option contracts. Such report shall be made available using the most recent versions of the XML schema and the associated PDF renderer as published on the Commission's Web site for all reports required by this section. Each section in a report shall include the following information:

(i) The percentage of total orders for the section that were non-directed orders, and the percentages of total non-directed orders for the section that were market orders, marketable limit orders, non-marketable limit orders, and other orders;

(ii) The identity of the ten venues to which the largest number of total non-directed orders for the section were routed for execution and of any venue to which five percent or more of non-directed orders were routed for execution, the percentage of total non-directed orders for the

section routed to the venue, and the percentages of total non-directed market orders, total non-directed marketable limit orders, total non-directed non-marketable limit orders, and total non-directed other orders for the section that were routed to the venue;

(iii) For each venue identified pursuant to paragraph (a)(1)(ii) of this section, the net aggregate amount of any payment for order flow received, payment from any profit-sharing relationship received, transaction fees paid, and transaction rebates received, both as a total dollar amount and per share, for each of the following non-directed order types:

(A) Market orders;

(B) Marketable limit orders;

(C) Non-marketable limit orders; and

(D) Other orders.

(iv) A discussion of the material aspects of the broker's or dealer's relationship with each venue identified pursuant to paragraph (a)(1)(ii) of this section, including a description of any arrangement for payment for order flow and any profit-sharing relationship and a description of any terms of such arrangements, written or oral, that may influence a broker's or dealer's order routing decision including, among other things:

(A) Incentives for equaling or exceeding an agreed upon order flow volume threshold, such as additional payments or a higher rate of payment;

(B) Disincentives for failing to meet an agreed upon minimum order flow threshold, such as lower payments or the requirement to pay a fee;

(C) Volume-based tiered payment schedules; and

(D) Agreements regarding the minimum amount of order flow that the broker-dealer would send to a venue.

(2) A broker or dealer shall make the report required by paragraph (a)(1) of this section publicly available within one month after the end of the quarter addressed in the report.

(b) *Customer requests for information on order routing.* (1) Every broker or dealer shall, on request of a customer, disclose to its customer, for:

(i) Orders in NMS stocks that are submitted on a held basis;

(ii) Orders in NMS stocks that are submitted on a not held basis and the broker or dealer is not required to provide the customer a report under paragraph (b)(3) of this section; and

(iii) Orders in NMS securities that are option contracts, the identity of the venue to which the customer's orders were routed for execution in the six months prior to the request, whether the orders were directed orders or non-directed orders, and the time of the transactions, if any, that resulted from such orders. Such disclosure shall be made available using the most recent versions of the XML schema and the associated PDF renderer as published on the Commission's Web site for all reports required by this section.

(2) A broker or dealer shall notify customers in writing at least annually of the availability on request of the information specified in paragraph (b)(1) of this section.

(3) Except as provided for in paragraphs (b)(4) and (5) of this section, every broker or dealer shall, on request of a customer that places, directly or indirectly, one or more orders in NMS stocks that are submitted on a not held basis with the broker or dealer, disclose to such customer within seven business days of receiving the request, a report on its handling of such orders for that customer for the prior six months by calendar month. Such report shall be made available using the most recent versions of the XML schema and the associated PDF renderer as published on the Commission's Web site for all reports required by this section. For purposes of such report, the handling of a NMS stock order submitted by a customer to a broker-dealer on a

not held basis includes the handling of all child orders derived from that order. Such report shall be divided into two sections: one for directed orders and one for non-directed orders. Each section of such report shall include, with respect to such order flow sent by the customer to the broker or dealer, the total number of shares sent to the broker or dealer by the customer during the relevant period; the total number of shares executed by the broker or dealer as principal for its own account; the total number of orders exposed by the broker or dealer through an actionable indication of interest; and the venue or venues to which orders were exposed by the broker or dealer through an actionable indication of interest, provided that, where applicable, a broker or dealer must disclose that it exposed a customer's order through an actionable indication of interest to other customers but need not disclose the identity of such customers. Each section of such report also shall include the following columns of information for each venue to which the broker or dealer routed such orders for the customer, in the aggregate:

(i) *Information on Order Routing*. (A) Total shares routed;

(B) Total shares routed marked immediate or cancel;

(C) Total shares routed that were further routable; and

(D) Average order size routed.

(ii) *Information on Order Execution*. (A) Total shares executed;

(B) Fill rate (shares executed divided by the shares routed);

(C) Average fill size;

(D) Average net execution fee or rebate (cents per 100 shares, specified to four decimal places);

(E) Total number of shares executed at the midpoint;

(F) Percentage of shares executed at the midpoint;

(G) Total number of shares executed that were priced on the side of the spread more favorable to the order;

(H) Percentage of total shares executed that were priced at the side of the spread more favorable to the order;

(I) Total number of shares executed that were priced on the side of the spread less favorable to the order; and

(J) Percentage of total shares executed that were priced on the side of the spread less favorable to the order.

(iii) *Information on Orders that Provided Liquidity*. (A) Total number of shares executed of orders providing liquidity;

(B) Percentage of shares executed of orders providing liquidity;

(C) Average time between order entry and execution or cancellation, for orders providing liquidity (in milliseconds); and

(D) Average net execution rebate or fee for shares of orders providing liquidity (cents per 100 shares, specified to four decimal places).

(iv) *Information on Orders that Removed Liquidity*. (A) Total number of shares executed of orders removing liquidity;

(B) Percentage of shares executed of orders removing liquidity; and

(C) Average net execution fee or rebate for shares of orders removing liquidity (cents per 100 shares, specified to four decimal places).

(4) Except as provided below, no broker or dealer shall be required to provide reports pursuant to paragraph (b)(3) of this section if the percentage of shares of not held orders in NMS stocks the broker or dealer received from its customers over the prior six calendar months was

less than five percent of the total shares in NMS stocks the broker or dealer received from its customers during that time (the "five percent threshold" for purposes of this paragraph). A broker or dealer that equals or exceeds this five percent threshold shall be required (subject to paragraph (b)(5) of this section) to provide reports pursuant to paragraph (b)(3) of this section for at least six calendar months ("Compliance Period") regardless of the percentage of shares of not held orders in NMS stocks the broker or dealer receives from its customers during the Compliance Period. The Compliance Period shall begin the first calendar day of the next calendar month after the broker or dealer equaled or exceeded the five percent threshold, unless it is the first time the broker or dealer has equaled or exceeded the five percent threshold, in which case the Compliance Period shall begin the first calendar day four calendar months later. A broker or dealer shall not be required to provide reports pursuant to paragraph (b)(3) of this section for orders that the broker or dealer did not receive during a Compliance Period. If, at any time after the end of a Compliance Period, the percentage of shares of not held orders in NMS stocks the broker or dealer received from its customers was less than five percent of the total shares in NMS stocks the broker or dealer received from its customers over the prior six calendar months, the broker or dealer shall not be required to provide reports pursuant to paragraph (b)(3) of this section, except for orders that the broker or dealer received during the portion of a Compliance Period that remains covered by paragraph (b)(3) of this section.

(5) No broker or dealer shall be subject to the requirements of paragraph (b)(3) of this section with respect to a customer that traded on average each month for the prior six months less than $1,000,000 of notional value of not held orders in NMS stocks through the broker or dealer.

* * * * *

§ 242.611 [Amended]

12. In § 242.611, paragraph (c) is amended by removing the text "§242.600(b)(30)" and adding in its place "§242.600(b)(31)".

§ 242.1000 [Amended]

13. In § 242.1000 the definition of *Plan processor* is amended by removing the text "§242.600(b)(55)" and adding in its place "§242.600(b)(59)".

By the Commission.

Dated: November 2, 2018.

Brent J. Fields,
Secretary.

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