September 26, 2016

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Disclosure of Order Handling Information (Release No. 34-78309; File No. S7-14-16)

Dear Mr. Fields:

Better Markets[1] appreciates the opportunity to comment on the above-captioned proposal ("Proposal" or "Rule Proposal") released for comment by the Securities and Exchange Commission ("SEC" or "Commission"). We commend the Commission and the staff for a pro-investor, pro-transparency, and pro-fairness proposal. With some important improvements, we believe it should be finalized as proposed.

We are supportive of the Commission's efforts to increase transparency, improve "best execution," stem information leakage, and above all, reduce conflicts of interest by requiring certain disclosures of order routing information for institutional investors and improving upon the disclosures already available to retail investors. The Proposal should help on all these public policy goals.

We are also encouraged by Commission's enduring philosophy that "Sunlight is the best disinfectant" and its appropriate confidence in the disclosure regime as a way to empower and protect investors and markets while facilitating capital formation. It is axiomatic that disclosure cannot alone solve all ills and, often, is insufficient, but it has been a hallmark of the SEC's mission from the start and continues to be a key foundational pillar for our markets and investors. We hope this view will apply and carry over to the ill-advised so-called Disclosure Effectiveness Initiative (currently being pursued by the Division of Corporation Finance). Investors will be ill-served if the Commission strengthens and increases disclosures in the areas of broker-dealer transactions but reduces or eliminates disclosures in issuer filings. The wisdom of the Commission's prioritization and belief in disclosure to empower investors and protect markets in this context

1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

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applies with equal force in the areas under review in connection with the Disclosure Effectiveness Initiative.[2]

SUMMARY

We applaud the Commission's efforts to strengthen its rules to increase transparency in order routing by requiring broker-dealers to disclose certain information. We agree with the Commission that providing this information to investors (institutional or retail) in a readily accessible format and within reasonable timeframes (as proposed), will empower them to make more informed decisions in selecting broker-dealers. Such information would shed light on whether broker-dealers act in the interest of investors or seek to improve profits by "monetizing client order flow"[3] through interaction with the firm's proprietary trading groups, creating opportunities for information leakage through excessive interaction with principal trading firms within the broker-dealers alternative trading system, receiving payment for order flow with professional intermediaries, or maximizing the rebates the broker-dealers receive from trading venues.

However, we are concerned that investors may be shortchanged and that the goals of ensuring best execution, uncovering harmful conflicts of interest, and preventing information leakage may not be met if the proposal is not strengthened in certain important respects. Accordingly, in our comments, we identify particular ways to make the reports more robust and detailed.

COMMENTS

The Commission proposes to amend Rules 600 and 606 of Regulation NMS to require disclosures of order handling information of institutional orders by broker-dealers, and to add to existing disclosures with respect to retail orders. Specifically, with respect to institutional orders, the Commission is proposing to amend Rule 606 of Regulation NMS "to require a broker-dealer, upon request of its customer, to provide specific disclosures, for the prior six months, broken down by calendar month, related to: (1) The handling of the customer's institutional orders at the broker-dealer; (2) the routing of the customer's institutional orders to various trading centers; (3) the execution of those orders, and the quality of execution; 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. This information would be provided for each venue, and would further be divided into passive, neutral, and aggressive order routing strategies." In addition, the Commission proposes to amend certain definitions under its Rule 600 of Regulation NMS of the terms ''institutional order,'' ''actionable indication of interest,'' ''orders providing liquidity,'' and ''orders removing liquidity,'' and to rename the defined term ''customer order'' to ''retail order.'' The Commission also is proposing to amend Rule 606 of Regulation NMS to require a broker-dealer to make publicly available the new disclosures on an aggregated basis.[4]

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2 *See* Better Market's July 21, 2106 comment letter "Business and Financial Disclosure Required by Regulation S-K; Concept Release." Available at https://www.sec.gov/comments/s7-06-16/s70616-312.pdf.

3 *See* "Is Barclays Unique?" http://www.pragmatrading.com/blog/is-barclays-unique/

4 *See* "Disclosure of Order Handling Information." Federal Register, Vol. 81, No. 144. Available at https://www.gpo.gov/fdsys/pkg/FR-2016-07-27/pdf/2016-16967.pdf ("Proposal"). At p.49434.

With respect to retail orders, the Commission "is proposing to: (1) Require limit order information to be split into marketable and non-marketable categories; (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 its order routing decisions; (4) require that broker-dealers keep retail order routing 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; and (5) eliminate the requirement to group retail order routing information by listing market." Finally, like Rule 606, the Commission proposes to require the posting of execution reports on the Web.[5]

As the Commission repeatedly illustrates in the Proposal, today's capital markets are ruled by computers and algorithms. The types of market participants behind these machines, often engaged in high-frequency trading, benefit enormously from captive payment for order flow arrangements, predictable order routing of broker-dealers, complex fee structures and rebates, and the order types designed to capture those rebates. For example, according to a recent study,[6] the four major exchanges (NYSE, NASDAQ, BATS and Chicago Exchange) have over 830 pricing levels for broker-dealers and other participants to choose from (or be confused by). Investors are ill-served by broker-dealers who do not have a clear understanding of the true cost of trading, or worse, when they hide that important information from investors.

Today, as the Proposal states, "institutional orders tend to be routed and executed using sophisticated order execution algorithms developed by broker-dealers or others that break up large institutional orders into smaller ''child'' orders, [which are then sent via] smart order routing systems to route those child orders to the full range of trading centers in the national market system, including exchanges, ''dark pool'' alternative trading systems (''ATSs''), and internalizing broker-dealers."[7] The Commission further states that "the complexity of order execution algorithms and smart order routing systems, and the multiplicity of venues to which broker-dealers may route orders or send actionable indications of interest, have made it increasingly difficult for institutional customers to assess the impact particular order routing strategies may have on the quality of their executions, or the risks presented by any resulting information leakage or broker-dealer conflicts of interest."[8]

The Commission Should Require a More Detailed Report as Part of Regular Public Reporting

The Commission should require the publication of a more detailed report by broker-dealers, for comparative review by institutional investors, retail investors, or their investment advisers, to better achieve the goals set out by the Commission: increased transparency, truer "best execution,"

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5 *See* Proposal at p.49434-5.

6 *See* "Stock Exchange Prices Grow So Convoluted Even Traders Are Confused, Study Finds." Available at http://www.nytimes.com/2016/03/02/business/dealbook/stock-exchange-prices-grow-so-convoluted-even-traders-are-confused-study-finds.html.

7 Proposal at p.49433.

8 *See id.*

reduced information leakage, and disclosure of any conflicts of interest. Furthermore, the Commission should increase the level of broker-dealer order routing disclosure necessary to improve investor understanding of whether a broker is adhering to FINRA Rule 5310[9] including "…routing a customer order (or portion of a customer order) to multiple ATSs, a practice of routing to a particular trading center (e.g., an internal or affiliated ATS) before other routing decisions are made, or repeated routing to the same ATS, and whether such practices may result in information leakage, and the impact of any information leakage on execution quality." Additionally, increased disclosure would allow investors to determine whether broker-dealers are able to "compare the quality of executions it is obtaining via current order routing and execution arrangements (including the internalization of order flow) to the quality of the executions that it could obtain from competing markets."

Ownership of the Venue: Investors (both institutional and retail) should be aware of potential conflicts of interest when broker-dealers route orders to trading venues in which the broker-dealer has a direct or indirect ownership interest. Similarly, investors can benefit from increased awareness of the potential for disparate treatment among trading venues by broker-dealers, including more favorable treatment toward those venues in which the broker-dealer (or an affiliate) has an ownership interest

Disclosure of Economic Inducements: All investors can benefit from increased awareness of potential conflicts of interest when broker-dealers route orders because of economic inducements (rebate or discounts), as such rebates may impact the quality of executions.[10] All of these rebates or discounts should be disclosed, and not just those related to retail orders only.

Disclosure of Material Business Relationships: Broker-dealers should be required to disclose whether the firm has a material relationship with a trading venue or an affiliate of a trading venue to which the firm routes institutional or retail investor orders (e.g., prime brokerage, affiliate broker-dealer, etc.) Such heightened disclosure would enable a more thorough examination of whether best execution has been achieved when potential conflicts of interest exist.

Disclosures of Quality of Execution: All investors would benefit from increased awareness of the potential for differences in the quality of execution achieved by broker-dealers across different trading venues because of a broker-dealer's own unique interaction with a venue. In other words, investors should know whether a broker-dealer routes orders (e.g., percentage of non-directed orders, order size, marketability, liquidity) to affiliate trading venues, venues that provide economic inducements, or venues with which the firm has a material business relationship, as opposed to other venues that may be designed to reduce information leakage and promote opportunities for interaction among natural investors.

Reg SCI: All investors should be able to know whether broker-dealers send their orders to venues that are subject to Regulation SCI and broker-dealers should be subject to heightened disclosure and a more thorough examination of best execution when routing investor orders to

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9 *See* FINRA Regulatory Notice 15-46, November 2015 https://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-46.pdf.

10 *See* Can Brokers Have it All? On the Relation between Make-Take Fees And Limit Order Execution Quality https://business.uc.edu/content/dam/business/departments/finance/docs/Robert_Battalio_Paper.pdf.

venues that are not subject to Reg SCI. Reg SCI requires heightened information technology standards, and Reg SCI also subjects these firms to a more detailed examination and inspection regime and increased disclosure.[11]

Order Classifications: All types of orders, across all types of participants, and all levels of marketability (i.e. price point relative to NBBO) should be disclosed. Broker-dealers should be required to classify and disclose information according to an entity classification (e.g., institution, retail investor, or broker-dealer). Such a classification should not be a function of unique order handling typical of an entity type or the typical size of an order from an entity type, as such characteristics change over time, whereas the entity type itself remains constant. Moreover, institutional and retail investors should not be defined in terms of order size but instead by the nature of the investor: entity or individual person. Orders should be classified based on whether they are "immediate or cancel" versus "eligible to remain" in the market. Order aggressiveness should be a function of the child order limit price or market price relative to the prevailing NBBO at the time a child order is routed to a venue for execution.

Standardized Broker Order Routing Disclosure Enables Venue Comparison: Standardized order routing disclosures across all broker-dealers could be used to conduct venue-specific analysis based upon the disclosed information across a large number of broker-dealers that use that venue.

We propose that the Commission require the inclusion of the following data in the reports broker-dealers regularly and publicly produce. The Commission should require the disclosure of the below data from broker-dealers across all the exchanges, ATSs, 3rd party brokers or such broker-dealer's own internalizers to which the broker-dealer routes the customer's orders.

For Institutional Customer Order Handling:

Institutional Customer Order Handling
% of Total Non-Directed Institutional Customer Orders Routed[12]
% of Total Non-Directed Institutional Customer Orders Executed[12]
% of Non-Directed Institutional Customer Orders Executed that Resulted in a Rebate or Free Execution[13]

11 It is worth noting that some venues are not subject to Reg SCI. If investors are made aware of this fact, it might raise their expectations of these venues, and they might, through their broker-dealer or investment adviser, prefer venues that are subject to Reg SCI. *See* Better Markets' July 8, 2013 comment letter on "Regulation Systems Compliance and Integrity." *Available at* https://www.sec.gov/comments/s7-01-13/s70113-38.pdf.

12 Allows investors to determine whether a broker-dealer is favoring particular venues due to ownership or economic inducement and the resulting potential for information leakage, thereby allowing investors to compare whether other broker-dealers, without such conflicts of interest, route to the same or different venues.

13 Allows investors to determine whether a broker-dealer is realizing a profit, in addition to any commissions or fees, as a result of order routing, thereby allowing investors to compare if other brokers are more typically routing in the best interest of the investor, rather than because of the economic inducement.

% of Non-Directed Institutional Customer Orders Routed using a Marketable Price[14]
Average Routed Order Size on Marketable Non-Directed Institutional Customer Orders[15]
Median Routed Order Size on Marketable Non-Directed Institutional Customer Orders[15]
% of Non-Directed Institutional Customer Orders Sent as Immediate or Cancel (or Fill or Kill)[16]
Average Resting time for Non-Directed Institutional Customer Orders (non-IOC)[17]
Median Resting time for Non-Directed Institutional Customer Orders (non-IOC)[17]
% of Non-Directed Institutional Customer Orders > 100 Shares[18]
% of Non-Directed Institutional Customer Orders Sent as Odd Lot Orders[19]
% of Non-Directed Institutional Customer Orders Sent as Block Sized Orders[20]
% of Non-Directed Institutional Customer Orders Executed at the NBBO[21]
% of Non-Directed Institutional Customer Orders Executed Inside the NBBO (Excluding Midpoint)[21]
% of Non-Directed Institutional Customer Orders Executed Outside of the NBBO[21]
% of Non-Directed Institutional Customer Orders Executed at Midpoint of the NBBO[21]
% Non-Directed Institutional Customer Orders Routed in Small Cap Names[22]
% Non-Directed Institutional Customer Orders in Mid Cap Names[22]
% Non-Directed Institutional Customer Orders in Large Cap Names[22]
% of Total Directed Institutional Customer Orders[23]

14 Allows investors to determine the venues to which broker-dealers are routing investor orders and where the order has a higher probability of executing based on the marketability of the order. Investors can compare that information across brokers and venues.

15 Allows investors to determine if broker-dealers are sending larger orders to venues where the broker has a conflict of interest or receives an economic inducement. Investors can compare that information across brokers and venues.

16 Allows investors to determine if brokers are using certain venues for detecting potential counterparty interest through immediate or cancel pinging, potentially creating information leakage, rather than resting orders on venues designed to protect investor orders from information leakage. Investors can compare that information across brokers.

17 Allows investors to determine whether broker-dealers are resting orders on venues in which the firm has a conflict of interest or economic order routing inducement.

18 Allows investors to determine which venues a broker-dealer is sending a high percentage of orders to that are larger than the typical round lot.

19 Allows investors to consider which venues a broker-dealer is sending a high percentage of odd lot orders to and whether the broker may be uniquely disadvantaging a venue. Investors can compare that information across brokers and venues.

20 Allows investors to consider which venues a broker-dealer is sending a high percentage of block size orders to and consider whether the Firm has a conflict of interest with those venues. Investors can compare that information across brokers and venues.

21 Allows investors to assess the execution quality achieved by broker-dealers on various venues and use the information for comparative purposes across venues and broker-dealers.

22 Allows investors to determine which venues a broker-dealer is sending orders to based on a measure of liquidity and use the information for comparison across venues and broker-dealers.

23 Allows investors to evaluate which venues are being used by other investors whenever the broker-dealer does not have order routing discretion.

For Retail Customer Order Handling:

Retail Customer Order Handling
% of Total Non-Directed Retail Customer Orders Routed[12]
% of Total Non-Directed Retail Customer Orders Executed[12]
% of Non-Directed Retail Customer Orders Executed that Resulted in a Rebate or Free Execution[13]
% of Non-Directed Retail Customer Orders Routed using a Marketable Price[14]
Average Routed Order Size on Marketable Non-Directed Retail Customer Orders[15]
Median Routed Order Size on Marketable Non-Directed Retail Customer Orders[15]
% of Non-Directed Retail Customer Orders Sent as Immediate or Cancel (or Fill or Kill)[16]
Average Resting time for Non-Directed Retail Customer Orders (non-IOC)[17]
Median Resting time for Non-Directed Retail Customer Orders (non-IOC)[17]
% of Non-Directed Retail Orders > 100 Shares[18]
% of Non-Directed Retail Customer Orders Sent as Odd Lot Orders[19]
% of Non-Directed Retail Customer Orders Sent as Block Sized Orders[20]
% of Non-Directed Retail Customer Orders Executed at the NBBO[21]
% of Non-Directed Retail Customer Orders Executed Inside the NBBO (Excluding Midpoint)[21]
% of Non-Directed Retail Customer Orders Executed Outside of the NBBO[21]
% of Non-Directed Retail Customer Orders Executed at Midpoint of the NBBO[21]
% Non-Directed Retail Customer Orders Routed in Small Cap Names[22]
% Non-Directed Retail Customer Orders in Mid Cap Names[22]
% Non-Directed Retail Customer Orders in Large Cap Names [22]
% of Total Directed Retail Customer Orders [23]

<u>Other Important Comments: Best Execution for Venues; Order Flow Payments; Institutional Adviser; Additional Disclosures When Requested; Evaluate the Requirements in Three Years</u>

<u>Venues Should Be Subject to the Same Duties of Care as Broker-Dealers:</u> While broker-dealers are under "best execution" obligation, venues they route their orders to (which may themselves re-route to other venues) are not subject to the same trading obligations. The Commission should harmonize the duties of care.

<u>Order Flow Payments Should Be Clearly Disclosed:</u> Broker-dealers should disclose to both retail and institutional customers the nature of payment for order flow and profit-sharing relationships between broker-dealers, including affiliates, and specified venues. Furthermore, broker-dealers should disclose whether or not they pass any of the rebates or order-flow payments to the same customers whose handling of orders had generated such payments.

<u>Clients of Institutional Investment Advisers Should Have Access to the Same Report as the Adviser:</u> We agree with the Commission that if an institutional investment adviser, acting on behalf of multiple underlying clients, requests a report from a broker-dealer on the financial

inducements it may receive from a trading venue, then the adviser is entitled to the information on all routing orders processed on behalf of the requester's underlying clients. But we disagree with Commission's preliminary conclusion that "the investment adviser, as the customer of the broker-dealer, [should] be the sole entity to whom the broker-dealer is required to provide a report under the proposed rule; and not the multiple underlying clients of the investment adviser."[24] We believe that an institutional investor should have the ability to request the same report that his or her adviser is privy to. The same benefit that the institutional investment adviser receives from gaining access to routing information would be useful to the adviser's clients. In practice this should not be a major hurdle for at least two reasons: First, most institutional investors will go to their advisers to gain a better understanding of routing practices, and second, the same report that the broker-dealer prepares for the institutional investment adviser can be furnished to his or her underlying clients (i.e., institutional investors), and vice versa. Finally, allowing clients to independently analyze routing information would serve as an extra check on conflicts of interest, especially in cases where the institutional investment adviser engages an affiliated broker-dealer.

<u>Additional Information Should Be Provided to Investors Upon Request</u>: Institutional and retail investors should have the right to know additional information about individual orders and executions that occurred during the preceding six months. In addition to the information already required under revised Rule 606,[25] Customer Requests for Information, brokers should be required to provide the following additional information so that investors can understand the state of the market at the time of the execution and whether the broker-dealer was using a venue in which there is a conflict of interest or economic order routing inducement:

- Whether the broker marked the investor order attributed on a market data feed or through a captive order routing arrangement;
- NBBO at time of order receipt by the broker (millisecond precision);
- NBBO at time of each child fill (millisecond precision);
- Venue for each child fill;
- Whether the broker has any ownership interest in the venues used for executing the orders;
- Whether the broker has any material business relationships with the venues used in execution of the order;
- Amount of any fee or rebate received by the broker-dealer on each child fill.

<u>Commission Should Revise the Required Report Items After Three Years:</u> The Commission should re-evaluate the disclosure requirements after three years, with the goal of identifying the most frequently requested, but unsatisfied, data fields. After this analysis, the Commission should consider adding those data fields to those already required by this Proposal.

<u>CONCLUSION</u>

The Commission has proposed a strong rule to increase transparency, improve "best execution," stem information leakage, and reduce conflicts of interest by requiring certain

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[24] Proposal at p.49448.

[25] *See* SEC Rule 606: Customer Requests for Information. http://www.ecfr.gov/cgi-bin/retrieveECFR?gp=1&ty=HTML&h=L&mc=true&r=SECTION&n=se17.4.242_1606

disclosures of information by broker-dealers of their order routing practices. For smaller institutional investors (who in the past did not have the negotiating leverage to request the information from broker-dealers), this information would be new and empowering. Institutional investors, and their underlying clients, will be better informed when selecting broker-dealers. Retail investors will also benefit, as will the regulators, journalists, and financial analysts who use such data.

This increased transparency will help reveal the true costs of transactions, serve as a check on conflicts of interest prevalent in today's markets, and enable investors to select broker-dealers who steer their orders to venues that help their clients achieve truer "best execution." Ultimately, this enhanced level of transparency will promote the integrity of our markets and increase investor confidence—essential ingredients of robust capital formation.

We hope these comments are helpful as you finalize the Proposal.

Sincerely,

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