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Securities and Exchange Commission
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Re: Disclosure of Order Handling Information

File S7-14-16

August 26, 2016

Dear Securities and Exchange Commission:

Here are my comments on this proposal:

Summary

- The proposed changes do little for retail investors.
- Rule 606 should be updated to require disclosures of retail execution quality, not just routing.

[1] All opinions are strictly my own and do not necessarily represent those of Georgetown University or anyone else for that matter.

Introduction

SEC Rule 605 requires market centers to display various execution quality statistics, and Rule 606 requires brokerage firms to provide vague disclosures on where they route customer orders. The rules were designed in the pre-modern era to bring some transparency to order routing and execution practices.

The apparent logic was that retail investors would be able to see where their brokers were routing orders along with the execution quality of various market centers. When investors combined the Rule 605 and 606 reports, they would be able to tell whether their brokers were routing to good or bad market centers. This transparency would create competitive pressure on brokers to pay attention to execution quality.

Alas, the resulting disclosures, while interesting to academics, have been totally useless for retail investors. Most retail investors are totally unaware of the existence of these reports. Few have the expertise to interpret them. The Rule 605 data on execution quality are too raw for most investors to interpret. The Rule 606 data on order routing practices is interesting but gives most investors very little information with which to judge the quality of the services provided by the brokers.

The Commission is wise to re-examine these flawed rules. The proposal requires substantial disclosures for institutional orders and additional disclosures for retail orders. I am commenting from my own perspective as a retail investor and will leave a discussion on the institutional proposals to others.

Page 13 of the proposing release states:

> The Commission preliminarily believes that simplified and enhanced disclosures for retail orders, particularly with respect to financial inducements from trading centers, should assist retail customers in evaluating better the order routing services of their broker-dealers. Additionally, public transparency of retail orders should drive competition as broker-dealers seek to compete on the basis of the quality of their order routing and execution services as well as their ability to manage conflicts of interest.

Unfortunately, the proposed changes to Rule 606 do not provide "the simplified and enhanced disclosures for retail orders" needed to achieve the Commission's objective to improve competition based on execution quality.

Execution quality is a function of BOTH order routing and market center.

There is a fundamental flaw in the logic of Rules 605 and 606. The structure of the rules implicitly assumes that execution quality is solely a function of the market center and that the brokerage firm has no impact on execution quality. An investor could pick which brokers are better by seeing who routes to the best market centers. This is not true. Market conditions change rapidly. The market with the best price one moment may have the worst price a millisecond later. A good broker picks the right market center for a given order at a given time. Indeed, the better brokers use sophisticated order routing technology to get best execution for their clients. Execution quality is thus a product of BOTH the broker's skill and the quality of the market center's execution. Merely forcing brokers to show where they route orders gives retail investors no useful information on the actual execution quality they receive.

Brokers should be required to display execution quality statistics, not just routing information.

A better solution would be to require each broker to produce execution quality statistics for their clients. Most brokers already gather this information to monitor whether they are giving their customers best execution. Brokerage firms should release two sets of data:

- Each trade confirmation for marketable orders should contain the NBBO at the time of order receipt (if the order was received during normal trading hours) and calculate the difference between the quote at the time the order was received and the execution price. The confirmation would also display the date and time of the order receipt and the date and time of order execution.

- Brokerage firms would also be required to prominently display on their web sites summary execution quality statistics in an easy to interpret manner. Such a display would allow consumers to quickly compare execution quality across brokerage firms and thus assist consumers in choosing brokerage firms that provide good execution quality. Customer complaints are also an important part of execution quality, so the number should be displayed relative to the number orders.

As the overwhelming majority of retail trades are less than 200 shares, a simple format that displays the results only for orders less than 200 shares might be appropriate. Here is an example of what such a report card might look like:

Execution Quality Report **Generic Broker** **Marketable Retail Orders Received During Normal Trading Hours** **(9:30 am to 4:00 pm)** **Orders less than 200 shares** **Month, Year**	
Average price relative to quote (Higher is better)	$0.000
Percent executed outside the bid-ask spread	0.25%
Percent executed at quote	78.00%
Percent executed inside bid-ask spread	21.75%
Number of orders	50,280
Number of complaints regarding these orders	2
Average price relative to quote is the average for buy orders of (Ask Quote – Execution Price) and for sell orders of (Execution Price – Bid Quote).	

Note that this table gives the information really relevant for a retail investor: The trade-through rate (getting an execution price worse than the quote), the likelihood of something bad happening (the complaint rate), and the likelihood and magnitude of price improvement.

If one wants more granularity, one could break the statistics down by size of order and add limit order execution quality as follows:

Execution Quality Report Generic Broker Marketable Retail Orders Received During Normal Trading Hours (9:30 am to 4:00 pm) Month, Year				
	Odd lots < 100 shares	100-499 shares	500-999 shares	1000 +shares
Average price relative to quote (Higher is better)	$0.000	$0.001	($0.001)	($0.015)
Percent executed outside the bid-ask spread	0.00%	0.35%	1.5%	5.2%
Percent executed at quote	100.00%	84.15%	87.23%	70.12%
Percent executed inside bid-ask spread (when spread > 1 cent)	0.00%	20.10%	12.98%	3.14%
Average execution time (seconds)	.8 seconds	.6 seconds	1.5	9.8
Number of marketable orders	5,280	3,141,592	2,718	1,414
Number of other orders	1,234	2,718,281	5,280	1,732
Number of complaints (all orders)	0	1	2	0

This table displays execution quality statistics for market (including marketable limit) orders received during regular trading hours. Other orders consist of orders received outside regular trading hours (9:30 am to 4:00 pm EST), limit orders, stop orders, and orders with special handling conditions including “not held” orders or orders in which the customer specified that the order should be routed to a specific market.

Average price relative to quote is the average for buy orders of (Ask Quote – Execution Price) and for sell orders of (Execution Price – Bid Quote).

For marketable orders received outside normal market hours, what matters is the execution price relative to the open:

Execution Quality Report Generic Broker Market and Marketable Limit Orders Received Outside Normal Business Hours Month, Year				
	Odd lots < 100 shares	100-499 shares	500-999 shares	1000 +shares
Average price relative to official opening price (Higher is better)	$0.00	$0.001	($.002)	($0.008)
Number of orders	5,280	1,234,567	654,321	17,320
Average price relative to official opening price is the average for buy orders of (Official opening price– Execution Price) and for sell orders of (Execution Price – Official opening price)				

With non-marketable limit orders, what matters is the skill of the broker in choosing the venue with the highest probability of filling the order. Measuring execution quality is difficult in that some limit orders are placed far away from the NBBO and are unlikely to be filled. Others are cancelled after varying lengths of time for any number of reasons. It may be difficult to tell whether a cancelled order would have been filled later had it not been cancelled. However, probabilities of execution can be measured for uncancelled orders. Here is an example of some useful information on retail limit order execution quality.

Execution Quality Report Generic Broker Non Marketable Limit Orders Received Orders placed during normal market hours but not cancelled within 30 minutes of submission Month, Year				
	Odd lots < 100 shares	100-499 shares	500-999 shares	1000 +shares
Orders with limit priced in between NBBO at time of order submission. Percentage of orders filled.	75.2%	$66.6%	50.3%	45.1%
Number of orders	5,280	1,234,567	654,321	17,320
Orders placed at the NBBO Percentage of orders filled	50.2%	45.6%	35%	25%
Number of orders	7,777	2,345,678	345,678	45,678
Orders placed one tick outside the NBBO	20.0%	15.1%	13.9%	12.1%
Number of orders	6,666	122,222	22,222	11,111

Respectfully submitted,

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