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September 26, 2016

*Submitted electronically*

Mr. Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Re: Disclosure of Order Handling Information; File No. S7-14-16

Dear Mr. Fields,

Fidelity Investments (“Fidelity”)<sup>1</sup> appreciates the opportunity to provide comments on the Securities and Exchange Commission’s (the “SEC” or “Commission”) proposed amendments to require broker-dealers to provide additional disclosures to their customers about the routing of their orders.<sup>2</sup> Our comments reflect the views of an institutional asset manager, an institutional broker-dealer, and a retail broker-dealer who will be impacted by the Proposal.<sup>3</sup>

Fidelity supports SEC efforts to enhance the transparency of order routing practices. Standardized information about the manner in which brokers handle orders can help customers evaluate broker routing decisions, potential conflicts of interest, and the quality of trade executions. While we support the Proposal’s goals, we offer the following recommendations designed to increase the usefulness of the proposed disclosures and to mitigate the risk that proprietary information is disclosed to the public.

## **I. EXECUTIVE SUMMARY**

- The proposed Institutional order handling report was designed for institutional investors and is most appropriate for that audience. The proposed definition of “Institutional order” should be revised to encompass all of an institutional investor’s orders;

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<sup>1</sup>Fidelity and its affiliates are leading providers of mutual fund management and distribution, securities brokerage, and retirement recordkeeping services, among other businesses.

<sup>2</sup>Securities and Exchange Commission, Proposed Rule, *Disclosure of Order Handling Information*, Exchange Act Release No. 78309, 81 FR 49432 (July 27, 2016) *avail. at: <https://www.gpo.gov/fdsys/pkg/FR-2016-07-27/pdf/2016-16967.pdf>* (the “Proposal” or the “Proposing release”). Unless otherwise defined in this comment letter, capitalized terms have the meanings ascribed to them in the Proposal.

<sup>3</sup>Fidelity submits this letter on behalf of Fidelity Management & Research Company, the investment adviser to the Fidelity family of mutual funds; National Financial Services LLC (“NFS”), a Fidelity Investments company, SEC registered broker-dealer clearing firm and FINRA member; and Fidelity Brokerage Services LLC (“FBS”) a SEC registered introducing retail broker-dealer, FINRA member, and affiliate of NFS. NFS operates a market center and routes orders for NFS and FBS customers.

- The proposed requirement for broker-dealers to categorize their order routing strategies is not useful to institutional investors because the broker-dealer's decision to place a given strategy into a particular category is a subjective determination and is not comparable across broker-dealers. We recommend that the SEC eliminate this aspect of the proposal in the final rule;
- The proposed aggregated report for Institutional orders will be helpful for existing customers of the broker-dealer to put their customer specific reports in context, but should not be made publicly available; and
- In lieu of the Proposal's expansive and detailed disclosures for retail investors, the SEC should require broker-dealers to disclose certain execution quality statistics which will provide retail investors a more direct, relevant and understandable means to evaluate a broker's management of conflicts and the quality of their retail order routing practices.

Each of these recommendations is discussed in further detail below.

## **II. Institutional Order Routing Disclosures**

### **A. Definition of Institutional Order.**

For purposes of the proposed Institutional order handling report<sup>4</sup>, an Institutional order is defined in Proposed Rule 600(b)(31) 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 a broker-dealer." The proposed Institutional order handling report would include the routing of all child orders derived from Institutional orders even if those child orders are under \$200,000.<sup>5</sup>

The proposed definition of Institutional order distinguishes institutional and retail orders by the dollar size of the order, using the definition of Block size in Regulation NMS.<sup>6</sup> This methodology is both under- and over-inclusive for the following reasons:

- Not all of an institutional customer's orders would be included in the proposed Institutional order handling report. For example, any institutional customer's non-child order with a market value of \$200,000 or less would not be included in the report. As an institutional investor, we would like to see how a broker handled all of our orders, not just those of Block size or greater.
- It is not uncommon for retail customers to trade in Block size order increments which would be considered Institutional orders under the Proposal. The proposed Institutional order handling report was designed for institutional investors and is most

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<sup>4</sup>Proposed Rule 606(b)(3).

<sup>5</sup>Proposing Release at 44948 and Proposed Rule 606(b)(3).

<sup>6</sup>Under Rule 600(b)(9) of Regulation NMS, Block size with respect to an order means it is: (i) Of at least 10,000 shares; or (ii) For a quantity of stock having a market value of at least \$200,000.

appropriate for that audience. Moreover, including a Block size order from a retail customer in a broker-dealer's metrics will impact the broker-dealer's public, aggregated Institutional order handling report under Proposed Rule 606(c).

Rather than define an Institutional order based on a dollar threshold, for purposes of the Institutional order handling reports, we recommend that the SEC use a definition based on the customer segment that generated the order. Specifically, we believe that Institutional order should be defined as "any order coming from an institutional customer". While we do not have a specific alternative suggestion with respect to how institutional customer should be defined in this context, we suggest that the SEC consider several existing definitions, such as those found in FINRA Rule 4512(c)<sup>7</sup> or in U.S. Security Exchange's Retail Liquidity Programs.<sup>8</sup> In seeking to define Institutional order in this context, the SEC should work to ensure that the report is made available to its intended audience of institutional investors, not retail investors for whom other reports under Rule 606 may be more appropriate.

#### B. Content of Report – Generally.

*NMS Stocks.* As proposed, the Institutional order handling report would only include information on NMS stocks. We agree with the SEC's decision to limit the content of the report to only NMS stocks at this point in time. While additional components can be added to the report at a later date, we caution against making the rule too complicated during its initial phase.

*Standard Template.* As currently proposed, all broker-dealers would use a standard template for the Institutional order handling report. We fully support this approach because it allows institutional customers to compare common data metrics across broker-dealers and it allows broker-dealers to program their systems to a common template.

*Definition of Actionable indication of interest (IOI).* The SEC has proposed to include Actionable IOIs<sup>9</sup> in the Institutional order handling report to allow institutional customers to better understand how brokers handle their Institutional orders, particularly with regard to

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<sup>7</sup>FINRA Rule 4512(c) defines an "Institutional Account" as "the account of: (1) a bank, savings and loan association, insurance company or registered investment company; (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million."

<sup>8</sup>For example, NYSE Rule 107C(a)(3) defines a "Retail Order" as "an agency order or a riskless principal order that meets the criteria of FINRA Rule 5320.03 that originates from a natural person and is submitted to the Exchange by a Retail Member Organization, provided that no change is made to the terms of the order with respect to price or side of market and the order does not originate from a trading algorithm or any other computerized methodology."

<sup>9</sup>Proposed Rule 600(b)(1) would define Actionable Indication of Interest 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 previously solicited comment on the definition of an Actionable IOI on which Fidelity provided comments. See Regulation of Non-Public Trading Interest, Securities Exchange Act Release No. 60997, 74 FR 61208, 61219 (November 23, 2009) *avail. at:* <https://www.sec.gov/rules/proposed/2009/34-60997fr.pdf> Fidelity comments *avail. at:* <https://www.sec.gov/comments/s7-27-09/s72709-65.pdf>

information leakage. We generally believe that the proposed definition of Actionable IOI is appropriate but believe that it should be clarified to apply to “*electronic or electronically communicated* indications of interest.” We also have several questions regarding this definition, including the following:

There are several different order types that we believe meet the proposed definition of Actionable IOI. For example, we anticipate that conditional orders would fall under the proposed definition of an Actionable IOI. We suggest that the Commission provide examples of order types that would be considered Actionable IOIs in the final rule.

In the Proposal, the SEC expresses the opinion that an Actionable IOI is “the functional equivalent of an order.”<sup>10</sup> The regulatory implications of this statement are significant and lead us to question whether all existing rules, regulations and guidance that apply to orders would be applicable to Actionable IOIs under a final rule. For example, today, conditional orders are not OATS reportable, however orders are OATS reportable. If conditional orders are considered Actionable IOIs in the final rule, would firms need to start to report conditional orders to OATS? If the Proposal is adopted in its current form, we ask the Commission clarify this point.

Under the Proposal, a broker-dealer would be required to disclose the venue or venues to which Institutional orders were exposed through an Actionable IOI. The Proposal has not defined “venue” and we recommend that the SEC clarify that this term is intended to mean “market center” as defined in Rule 11Ac1-5(a)(14).<sup>11</sup> If the SEC does not limit the term “venue” to a market center, a broker-dealer would be required to disclose all non-market centers to which Institutional orders were exposed through an Actionable IOI. Non-market centers could encompass a broker-dealer’s proprietary client base, the public dissemination of which would be problematic from a competitive perspective.

*Requests for Institutional order handling report.* Under the proposal, institutional customers must request the report from their broker-dealer(s), who must provide the report within seven business days.<sup>12</sup> We agree that the report should be provided upon request and not automatically sent to all customers. Some institutional customers may request separate customized reports with data elements specific to their business and may not need the additional information provided in the proposed Institutional order handling report. Similarly, broker-dealers should not be required to notify institutional customers of the availability of the report. Institutional customers are sophisticated market participants who are aware of their resources and can best judge the type of information that meets their needs. We are also concerned that seven business days may not be an appropriate time period for a broker-dealer to respond to a customer request for this information. At this point in time, we are not certain how many clients may request the report --and whether they will request additional customized information be included into the report--which may impact report production times. We also note that current Rule

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<sup>10</sup>Proposing Release at 49446.

<sup>11</sup>Rule 11Ac1-5(a)(14) of the Securities Exchange Act of 1934 defines “market center” as “any exchange market maker, OTC market maker, alternative trading system, national securities exchange, or national securities association.”

<sup>12</sup>Proposed Rule 606(b)(3).

606(b) does not contain a time limit to respond to a retail customer request for information on order routing. We suggest that the SEC eliminate the seven business day response time in the final rule.

C. Order Routing Strategies.

The SEC proposes that each Institutional order handling report contain rows that would be categorized by, among other items, the routing strategy for Institutional orders at each venue.<sup>13</sup> The proposed categories for order routing strategies would include: (1) a “passive order routing strategy”; (2) a “neutral order routing strategy”; and (3) an “aggressive order routing strategy”. A broker-dealer would be required to assign each order routing strategy that it uses for Institutional orders to one of the three proposed categories, in a consistent manner for each report it prepares, and would be required to document the specific methodologies it relied upon for making such assignments. A copy of the methodology used would become part of the broker-dealer’s internal books and records.

We believe that assigning and including information on specific strategies for each order and order routing venue would not be useful information to institutional investors. We believe that it will be difficult for brokers to define their strategies into a single category given that many strategies are customized. Moreover, because the decision to place a given strategy into a particular category is a subjective determination, this information is not comparable across broker-dealers. We recommend that the SEC eliminate this aspect of the Proposal in the final rule.

D. Disclosure of information regarding net execution fees or rebates.

Venue fee schedules are complex, many venues change their rates during the month, and some venues are more transparent than others with respect to this information. For these reasons, calculation of execution fees and rebates is typically more of an art than a science. While we agree that execution fees and rebate information is important for customers to better understand and assess broker performance, we believe that this information should be provided as an estimate, rather than an exact amount in Proposed Rule 606(b)(3)(ii). It is also not clear to us what fee a broker should use if a broker executes a trade on its own ATS and seek clarification of this point if disclosure of information regarding net execution fees or rebates is included in the final rule.

E. Information on Orders that Provided Liquidity.

Proposed Rule 606(b)(3)(iii) would require disclosure of certain metrics concerning the provision of liquidity. We believe that it may be difficult for a broker to ascertain this information on its own because this information is typically provided by the venue. In order to comply with the proposed rule, we suggest that the Commission require venues to provide this information to all customers via a standard liquidity indicator, *i.e.* (1) Add; and (2) Remove.

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<sup>13</sup>Proposed Rule 606(b)(3) and Proposed Rule 606(b)(3)(v)(A)-(C).

F. Public, Aggregated Report for Institutional orders.

Proposed Rule 606(c) would require a broker-dealer to make publicly available, on a quarterly basis, a report that aggregates the information required for its customer-specific Institutional order handling reports for all Institutional orders it receives.

We believe the aggregated report would be particularly useful to existing institutional customers of the broker-dealer that request customer-specific reports. In this context, the aggregated report would allow the institutional customer to place their customer-specific report in context and to understand how the broker's handling of other customer's Institutional orders differed from the broker's handling of their own.

At the same time, we question the veracity of the data in the aggregated report. For example, if the aggregated report includes all orders and routing decisions, including those orders and strategies directed by the institutional customer, the report is not an accurate reflection of the broker's skill. Similarly, if retail customer orders of Block size are included in the public aggregated Institutional order report, the overall data will not reflect the broker's skill in executing orders placed by institutional customers. We also recognize that individual brokers and individual clients may have different trading activity from month to month and based on data from the public aggregated reports, we anticipate that it would be easy for market analysts to misinterpret and publicize these differences creating confusion in the market.<sup>14</sup>

Accordingly, in its proposed form, we believe that the public, aggregated report for Institutional orders would not serve its intended use. We recommend that similar to the customer specific Institutional order handling report, the SEC require broker-dealers to make the aggregated Institutional order handling report available only upon request to a broker-dealer's institutional customers, with directed orders and retail orders excluded from the data presented in the report.

**III. Retail Order Routing Disclosures**

A. The Proposed Expansive and Detailed Broker Order Routing And Conflicts Disclosures Should Be Replaced by Simple Execution Quality Statistics.

Currently, the SEC requires market centers to disclose monthly data about the quality of their trade execution. Each monthly report discloses execution quality data based on the previous month's trading activity. ("Rule 605 Reports") Separately, the SEC currently requires brokers that route orders on behalf of customers to prepare quarterly reports that disclose, among other items, information on: 1) the percentage of total customer orders that were non-directed orders and the percentages of total non-directed orders that were market orders, limit orders and

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<sup>14</sup>We note that the aggregated report could present potential competitive concerns for broker-dealers that should be explored further. For example, the aggregated reports should be reviewed to ensure that 1) broker-dealers can maintain a degree of confidentiality with respect to their business operations and 2) data presented cannot be reverse engineered to disclose information about their book of business.

other orders; 2) the identity of the venues to which a significant percentage of total non-directed orders were routed for execution; and 3) the terms of the material aspects of the broker-dealer's relationship with each venue identified, including a description of any arrangement for payment for order flow and any profit-sharing relationship ("Rule 606 Reports").

We do not believe that Rule 606 Reports are often used by retail customers to assess their broker's order routing and execution services. In the past 10 years, we have received no more than a handful of retail customer requests for this information. We believe that Rule 606 Reports are most often used by broker-dealers to assess how their order routing and execution services compare to other firms as well as by academics, members of the financial press, and wholesale market makers who review and evaluate this data as they seek to serve retail investor interests.

Missing from the current Rule 606 Reports is a means for a retail investor to determine how well their broker-dealer typically fills a retail order when compared to the "National Best Bid or Offer" (NBBO) at the time the order was received by the executing broker-dealer. Although a customer can request details on the identity of the venue, time of execution, and whether the order was directed to a specific venue per customer request, a customer would need to match this information to their broker's market center's Rule 605 Report to determine how well their broker filled their order compared to the NBBO.

The current proposal would provide investors with a series of expansive and detailed disclosures regarding a broker-dealer's retail order handling practices, presumably to spur competition for better execution quality among broker-dealers, which ultimately benefits the retail investor. We believe that a more direct, relevant and understandable means for retail customers to evaluate a broker's management of conflicts and quality of retail order routing practices is through execution quality statistics presented on a broker-by-broker basis.

We are not the first to recommend the SEC extend certain execution quality aspects of Rule 605 Reports to Rule 606 Reports.<sup>15</sup> Under our recommendation, a customer would compare the net result of their trade by a particular broker, *i.e.* did the broker save the customer money by getting a price that was better than the NBBO and/or did the broker supply the customer order with enhanced liquidity. We believe that the publication of these simple and clear statistics will help investors evaluate their particular broker in the context of the number of retail brokerage firms through whom they can trade. Our recommendation also avoids broker-dealers making costly and complex technology updates to their website to comply with the Proposed Rule's extensive disclosure requirements that we believe retail investors will ultimately not read. Specifically, we propose that the SEC require brokers to make publically available on

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<sup>15</sup>See Testimony of Joe Ratterman, Chief Executive Officer, BATS Global Markets, Inc. US Senate Permanent Subcommittee on Investigations (June 17, 2014) "Transparency could further be improved by amending Rule 606 to require disclosure about the routing of institutional orders, as well as separate disclosure regarding the routing of marketable and non-marketable orders, and the inclusion of execution quality data." See also, Securities and Exchange Commission Equity Market Structure Advisory Committee, Customer Issues Subcommittee, Recommendations Relating to Customer Issues (July 25, 2016) *avail.at*: <https://www.sec.gov/spotlight/emsac/emsac-customer-issues-subcommittee-recomendation-072516.pdf>

their websites statistics such as 1) Price Improvement<sup>16</sup>; 2) Execution Price<sup>17</sup>; 3) Execution Speed<sup>18</sup> and 4) Effective Spread.<sup>19</sup>

Fidelity's proposed approach is supported by our current practices. As a member of the Financial Industry Forum (FIF) we are one of the few firms that has volunteered to publish on a quarterly basis on our public website, [www.fidelity.com](http://www.fidelity.com), industry standardized statistics that measure the quality of trade executions on retail investor orders in exchange-listed stocks.<sup>20</sup> Current firms participating in the working group are Fidelity, Charles Schwab, and Scottrade. Many leading brokerage firms were asked by FIF to participate in this working group, but others chose not to participate.

We believe our recommendation to extend certain execution quality aspects of Rule 605 Reports to Rule 606 Reports, in lieu of the Proposal's complex disclosures, will provide investors more direct information upon which they can evaluate their brokers as well as avoid imposing costly and complex disclosure requirements on broker-dealers. Nevertheless, if the SEC determines to proceed with its Proposal in its current form, we offer the following additional comments.

#### B. Additional Comments.

*Marketable vs. Non-Marketable Limit Orders.* The SEC proposes to segregate marketable limit orders from non-marketable limit orders as a way to separate routing decisions based on marketability. The SEC believes that the change could increase competition and minimize conflicts of interest. This proposed change was also recommended by the SEC's Equity Market Structure Advisory Committee's Customer Issues Subcommittee.<sup>21</sup>

We do not disagree with the proposed definitions of marketable limit orders vs. non-marketable limit orders and agree that this breakout will provide valuable information to

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<sup>16</sup>Measured by percentage of shares executed at prices better than the prevailing NBBO.

<sup>17</sup>Measured by percentage of shares executed at or within the NBBO.

<sup>18</sup>Measured by the average period between the time the broker receives an order and the time of order execution.

<sup>19</sup>Measured by the distance from the midpoint of the market at the time when the customer's order was entered to the execution price the customer receives. This value would be doubled to capture the entire bid ask spread. This amount captures both how often, and by how much, a broker-dealer improves the price of a share.

<sup>20</sup>Participating firms are publishing the following metrics of their retail trade executions grouped by various order size ranges: Average size of orders, in shares, within each range; Percent of shares in market orders that were executed at current market quote or better; Percent of shares in market orders that received price improvement; Savings received on an average order as a result of price improvement; Average execution speed, in seconds, between order routing and trade execution. The FIF template for Retail Execution Quality Statistics is *avail. at:* [https://fif.com/images/Retail\\_Execution\\_Quality\\_Statistics/FIF\\_Rule\\_605-606\\_WG\\_-\\_Retail\\_Execution\\_Quality\\_Stats\\_Retailer\\_Template.pdf](https://fif.com/images/Retail_Execution_Quality_Statistics/FIF_Rule_605-606_WG_-_Retail_Execution_Quality_Stats_Retailer_Template.pdf) and Fidelity's current metrics are *avail at:* [https://www.fidelity.com/bin-public/060\\_www\\_fidelity\\_com/documents/FIF-FBS-retail-execution-quality-stats.pdf](https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/FIF-FBS-retail-execution-quality-stats.pdf).

To aid in retail investors' understanding of the statistics included in these reports, a definition of terms and a set of Frequently Asked Questions to explain the meaning of each metric is also provided.

<sup>21</sup>Securities and Exchange Commission, Equity Market Structure Advisory Committee, Customer Issues Subcommittee, Recommendations Relating to Customer Issues (July 25, 2016) at footnote 15 *infra*.

customers. We currently do not divide limit orders between marketable and non-marketable categories and, like many firms, will need to break out this information in our internal systems if this aspect of the proposal is incorporated into the final rule.

*Net Payment for Order Flow and Transaction Fees and Rebates by Specified Venue.* The SEC believes that the lack of detailed disclosure on payment for order flow, payment from profit sharing relationships or access fee or transaction rebates presents retail customers with an incomplete picture of their broker's routing practices. The Commission proposes to amend Rule 606(a)(1) to require a significant number of new data fields to specify the net aggregate amount both as a dollar amount and on a per share basis for payments related to certain order types.

We believe that some level of payment for order flow information is necessary, but that the proposed disclosure presents too much information and will create more confusion than provide clarity to retail investors. In our experience, simple, clear communications help empower investors to make investing decisions that are in their best interest, particularly if the information is packaged in a format and context that is understandable and actionable by the average investor. Too much information can overwhelm investors, leading to confusion and/or inaction. If the SEC's goal is to enable retail investors to better evaluate their brokers, we believe that detailed information on execution quality as we have recommended above would provide a more direct, relevant and understandable measurement.

*Discussion of Arrangement Terms with Specified Venues.* Proposed Rule 606(a)(1)(iv) would require broker-dealers to describe any terms, written or oral, of payment for order flow arrangements or profit sharing relationships that may influence a broker-dealers routing decisions in a discussion of a broker-dealers' relationship with a specified venue. We believe that this proposed requirement will result in tremendous amounts of information to be disclosed and digested. Given that few retail investors actually read 606 reports, we question for whose benefit this information is ultimately designed. Additionally, U.S. Securities Exchanges provide volume tiered pricing which is outlined in rule filings made with the Commission. We ask the Commission to clarify in final rulemaking whether broker-dealers would be required to duplicate these rule filings in their Rule 606 Reports to address this aspect of the proposal.

*Additional Amendments to Retail Disclosures.* Fidelity supports the Commission's proposal to remove the requirement that a Rule 606(a)(1) report 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. We agree that this is stale information, no longer relevant, and not particularly useful. We recommend that rather than divide this data by listing market, the data be divided by S&P 500 Stocks vs. Other Exchange-Listed Stocks. We believe that this is a standard metric and is the same methodology we use to breakdown our execution quality statistics under the FIF Reports.

Fidelity also supports the Commission's proposal to break down by calendar month the proposed public retail order routing reports required by Rule 606(a)(1). We further believe that the public dissemination Rule 606 Reports should be consistent with the public dissemination of Rule 605 Reports, for example, by making both reports publically available on a monthly basis.

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Fidelity would be pleased to provide further information, participate in any direct outreach efforts the Commission undertakes, or respond to questions the Commission may have about our comments.

Sincerely,

A handwritten signature in blue ink, appearing to read "Howard Berman".

cc:

The Honorable Mary Jo White, Chairman  
The Honorable Kara M. Stein, Commissioner  
The Honorable Michael S. Piwowar, Commissioner

Mr. Rick Fleming, Investor Advocate

Mr. Stephen Luparello, Director, Division of Trading and Markets  
Mr. Gary Goldsholle, Deputy Director, Division of Trading and Markets  
Mr. David Shillman, Associate Director, Division of Trading and Markets