



October 17, 2016

**Via Electronic Mail ([rule-comments@sec.gov](mailto:rule-comments@sec.gov))**

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

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

Dear Mr. Fields:

The Securities Industry and Financial Markets Association (“SIFMA”)<sup>1</sup> submits this letter to comment on the above-referenced rulemaking proposal issued by the Securities and Exchange Commission (“Commission”). SIFMA supports the Commission’s proposal to increase order handling transparency. As a participant in the development of the order handling and disclosure template submitted for the Commission’s consideration,<sup>2</sup> we support the proposal’s goal of providing institutional clients with standardized information about their order handling and execution. In addition, we support increasing order routing transparency to retail customers.

That being said, we offer several suggestions for modifying the proposal that will provide for more useful disclosure to both clients and the public. In summary, we suggest the following:

- The distinction between retail-based and institutional-based disclosures should be based on “held” and “not held” order types, rather than building on the monetary thresholds that currently exist under Regulation NMS.
- Both the retail and institutional disclosures under Rule 606 should apply to all orders, including those for the account of a broker-dealer, and to all of a broker-dealer’s clients, including both “customers” and other broker-dealers.

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<sup>1</sup> The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

<sup>2</sup> See Securities Exchange Act Release No. 78309 (July 13, 2016), 81 FR 49432, 49434 n.5 (July 27, 2016).

- The subjective categorization of order routing strategies should be replaced with the objective criteria of grouping market orders, marketable limit orders, and limit orders.
- The public disclosure of institutional order handling information should break out the aggregated data by segmenting directed orders from non-directed orders to avoid providing the public with incomplete or inaccurate information about a broker-dealer's overall routing practices.

### **Scope of Disclosures/Definition of Institutional Orders**

SIFMA recommends that the Commission amend Rule 606 to apply the retail-focused disclosures to "held" orders and to apply the institutional-focused disclosures to "not held" orders. Under the proposal, the Commission would build off of the current definition of "customer order," which would be renamed "retail orders." Rule 600 of Regulation NMS defines the term "customer order" to mean:

an order to buy or sell an NMS security that is not for the account of a broker or dealer, but shall not include 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.

Under the proposal, the term "institutional order" would be defined to mean:

An order to buy or sell an NMS stock that is not for the account of a broker or dealer and is an order for a quantity of an NMS stock having a market value of at least \$200,000.

Using a monetary threshold to distinguish between retail and institutional activity will create methodological flaw by causing two separate undesirable outcomes: (1) the exclusion of institutional orders with a market value of less than \$200,000; and (2) the inclusion of orders from retail customers that fall under the monetary definition of "institutional order."

On the first point, institutional clients often break up their orders in a security across several broker-dealers. The aggregate of these orders may exceed a market value of \$200,000, but from the perspective of each broker-dealer with reporting responsibility under the proposed rule, those orders may not meet the definition of institutional order. As such, those orders would not be recorded in the institutional disclosure provided to clients under the proposal, resulting in an incomplete dataset.

On the second point, retail customers occasionally execute orders with market value in excess of \$200,000. If the strict monetary threshold is maintained, then a broker-dealer would be required to provide the required disclosures to retail customers who execute isolated "institutional orders." This would likely result in confusion for a small set of retail customers and an unnecessary administrative effort for broker-dealers to produce reports that would provide

little utility to those customers. In addition, this threshold would require a broker-dealer with no true institutional clients to satisfy the public disclosure requirements under the rule, which would provide no public utility if it were reporting on a de minimis amount of orders, none of which came from true institutional clients.

To resolve these concerns, the respective disclosure requirements should be based on whether the broker or dealer has discretion when handling the client's orders. As a general matter, broker-dealers do not have discretion in handling retail orders while they do have discretion in handling institutional orders. The terms "held" and "not held" are common terms of usage in the securities markets,<sup>3</sup> and they are referenced in Commission rules.<sup>4</sup> We understand that some not held orders may come from retail customers, and that institutional clients may send broker-dealers a small amount of held orders. However, we believe scoping the disclosures by these order types rather than through a monetary threshold will minimize under-inclusiveness. In making this suggestion, SIFMA is not advocating that an overall classification of retail or institutional client be based on held or not-held order types. Rather, SIFMA believes that for the purposes of this proposal, using not held orders as the distinguishing factor will better meet the objectives of the Commission by capturing what typically constitutes institutional order activity.

SIFMA also suggests that the Commission expand the scope of the proposal –and of Rule 606 more broadly – in two important regards. First, by applying the disclosure requirements to "clients," which would include both "customers" as defined in Rule 600 of Regulation NMS and broker-dealers that send orders for execution to the reporting broker-dealer. Second, by removing the exclusions for broker-dealer orders from the definitions of "customer order" and "institutional order."<sup>5</sup> Making these changes would further reduce under-inclusiveness in the proposal by increasing the amount of orders subject to the client disclosure requirement and, importantly, including a larger population of orders in the publicly-disclosed aggregated data.

These changes also would work to apply the institutional-focused order handling disclosure requirements to exchange routing brokers. Because the current definition of "customer order" and the proposed definition of "institutional order" exclude orders received from other broker-dealers,<sup>6</sup> exchanges do not currently provide disclosures pursuant to Rule 606,

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<sup>3</sup> A "not held" order is a market or limit order that gives the broker-dealer both time and price discretion.

<sup>4</sup> See, e.g., Rule 600(b)(15) of Regulation NMS (referring to orders submitted on a not held basis in the definition of the term "covered order.")

<sup>5</sup> As noted above, we believe the terms "customer order" (or "retail order") and "institutional order" should be replaced with "held" and "not held" orders. We offer this argument in the alternative.

<sup>6</sup> See Rule 600(b)(18) which defines "customer order" as an order to buy or sell an NMS security that is not for the account of a broker or dealer, but shall not include 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

and they would not be required to make the disclosures provided for under the proposal. Adopting the definition of “client” that we have suggested would bring exchange routing brokers within the scope of Rule 606. And by definition, exchange routing brokers receive orders on a “not held” basis because they have discretion on the time and place of execution.

Extending the disclosure requirements to exchange routing brokers is a logical and reasonable extension of the proposal, as it will provide market participants with a more complete picture as to how their orders are or may be handled, thereby enabling them to make more informed investment decisions. Exchange routing brokers provide a significant amount of order handling functionality and strategies well beyond simply routing orders to protected quotations in fulfillment of regulatory requirements under Rule 611 of Regulation NMS.<sup>7</sup> Clients would benefit greatly from receiving detailed information about how orders that their executing brokers route to exchanges are handled by the exchanges’ routing brokers. Moreover, market participants generally would benefit from having public access to aggregated routing disclosures about the various exchange routing brokers, because exchange routing behavior is one of the more opaque areas of the marketplace.

### **Categorization of Order Routing Strategies**

The proposed requirement to break out the disclosure by order routing strategy would introduce unnecessary subjectivity that would limit the comparability and utility of the client reports. Specifically, the proposal would require that each broker-dealer assign each order routing strategy that it employs to one of three categories – passive, neutral, or aggressive. It would be up to each broker-dealer to develop criteria for determining which strategies fall into the three categories. This subjective requirement would limit the comparability of the reports and result in erroneous conclusions. For instance, one broker-dealer may categorize a certain type of strategy as neutral, whereas a separate broker-dealer may categorize that same strategy as aggressive. Further, this standard does not take into account client specific customizations that may impact the performance of each strategy, thereby further reducing the comparability of the reports.

To address this, we suggest that the Commission eliminate the requirements to categorize order routing strategies. Instead, the client-specific institutional order reports should be provided at the venue level from the perspective of the broker-dealer’s suborders that are being routed to fulfill the underlying client’s investment objectives. In our view, the venue analysis should be based on objective standards that break down the orders into the categories of: (1) market orders;

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NMS security. *See also* Rule 11Ac1-6 Frequently Asked Questions *available at* <https://www.sec.gov/interps/legal/mrslb13a.htm>.

<sup>7</sup> *See e.g.* [https://www.nyse.com/publicdocs/nyse/markets/nyse-arca/ArcaRoutingProcess\\_FlowChart.pdf](https://www.nyse.com/publicdocs/nyse/markets/nyse-arca/ArcaRoutingProcess_FlowChart.pdf) (noting that NYSE ARCA offers smart order routing that provides access to multiple pools of liquidity, including non NMS venues).

(2) marketable limit orders; (3) limit orders; and (4) other orders (*e.g.*, pegged orders). Reporting at the venue rather than strategy level will reduce the unnecessary subjectivity that would occur with varying standards of categorization. Further, by measuring by the broker-dealer's suborders and associated type, the reports will reflect the actual handling of the client's order, including intent, which in turn will result in an easily comparable report that can serve as a baseline for further discussions.

### **Public Reporting of Institutional Trading Information: Proposed Rule 606(c)**

SIFMA supports increased public disclosure of order routing, but we suggest that the Commission modify the proposed requirements to publish aggregated data about institutional orders in order to avoid providing inaccurate or misleading data to the public. Proposed Rule 606(c) would require every broker-dealer that receives institutional orders to make publicly available a quarterly report that aggregates institutional order information, regardless of whether it is requested by clients pursuant to proposed Rule 606(b)(3). This aspect of the proposal does not take into account that the routing of an institutional order will vary depending upon the unique instructions of the clients. For instance, a client may direct a broker-dealer to preference orders to (or explicitly avoid) specific venues or specific types of venues.

By requiring that all institutional order information be aggregated, regardless of any routing instructions provided by the client, the information publicly disclosed will not provide an accurate portrayal of the independent routing logic employed by the broker-dealer. For example, a broker-dealer's institutional client – for example a “cost-plus” client – may direct a large portion of order flow to high-rebate venues. In such a case, analysis of the public data could lead to the conclusion that the broker-dealer itself has made the choice to capture the rebates when it is in fact acting on the direction of its clients. Conversely, some clients direct broker-dealers to avoid routing to a specific venues or types of venues. In either case, the analysis of the public data could lead to the conclusion that the broker-dealer made choices that misrepresent the default routing behavior of the broker.

Accordingly, we request that the Commission modify the proposal so that the public reports of aggregated data are broken out to reflect these differences. Using current definitions, the public reports could be segmented by “directed” and “non-directed” orders. However, the segmentation would be more accurate if it reflected a more nuanced distinction between orders that solely reflect the routing decisions or settings of the broker-dealer and orders that are subject to specific client routing instructions, even if the client does not identify a particular venue. SIFMA would appreciate the opportunity to further discuss with the Commission and the Staff how best to distinguish between orders guided solely by a broker-dealer's routing logic and orders where the client has provided its own routing directions, understanding that broker-dealers likely retain some discretion in the routing of such orders.

### **Definition of Actionable Indication of Interest**

The proposal to define the term “actionable IOI” presents policy issues outside the scope of the rulemaking proposal. Under the proposal, the term “actionable IOI” would be defined as any indication of interest (“IOI”) that explicitly or implicitly conveys all of the following information with respect to any order available at the venue sending the IOI: (i) symbol; (ii) side (buy or sell); (iii) a price that is equal to or better than the national best bid for buys orders or the national best offer for sell orders; and (iv) a size that is at least equal to one round lot. As currently defined, the proposed definition raises several questions and concerns that should be addressed prior to adoption.

In the proposal, the Commission expresses the position that an actionable IOI is the functional equivalent of an order or quotation. This statement raises questions outside the context of the proposal. For instance, is the Commission implying that quote and order rules, such as Rule 602 of Regulation NMS, in fact now apply to actionable IOIs? We request that the Commission clarify that such a statement was to simply provide additional definitional clarification for the proposed rule alone, and that there are no associated regulatory implications for actionable IOIs. Of course, any changes to existing rules should be subject to the formal rulemaking process before they are amended to apply to actionable IOIs.

The Commission also should make two other clarifications on the proposed definition of actionable IOI. First, the Commission should clearly provide that the definition of actionable IOI does not include conditional orders because there is a clear distinction between the two. In addition, the actionable IOI definition should not include manual transmissions, such as by telephone. An actionable IOI can be executed without any additional action by the counterparties as long as the terms correspond. In contrast, a conditional order requires an additional step by the counterparties, even if the terms otherwise correspond. To provide clarity, we suggest that the definition of actionable IOI be modified to explicitly exclude conditional orders, and to provide that it only applies to electronic transmission of information.

Mr. Brent J. Fields, Secretary, Securities and Exchange Commission  
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SIFMA greatly appreciates the Commission's consideration of the issues raised above and would be pleased to discuss these comments in greater detail with the Commission and the Staff. If you have any questions, please contact either me (at [REDACTED] or [REDACTED] or Timothy Cummings (at [REDACTED] or [REDACTED]).

Sincerely,



Theodore R. Lazo  
Managing Director and  
Associate General Counsel

cc: The Honorable Mary Jo White, Chair  
The Honorable Michael S. Piwowar, Commissioner  
The Honorable Kara M. Stein, Commissioner

Stephen Luparello, Director, Division of Trading and Markets  
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