September 28, 2023

Submitted electronically via SEC.gov
Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street NE Washington, DC 20549-1090

Re: SEC Disclosure of Order Execution Information Proposal (Release No. 34-96493; File No. S7-29-22)

Dear Ms. Countryman:

Charles Schwab & Co, Inc.[1] ("Schwab") appreciates the opportunity to provide supplemental comments on the Security and Exchange Commission ("SEC" or "Commission") proposal to enhance disclosure of order execution information under Regulation NMS Rule 605.[2] As noted in our letter dated March 1, 2013, Schwab strongly supports the goals of this proposal and believes the modernization and enhancement of execution quality disclosures will help provide investors with meaningful information to make informed decisions consistent with their investment goals. Comprehensive and accurate data is critical to enabling both regulators and market participants to assess the health of our markets and contribute to the identification of opportunities for improvement in a highly data driven manner.

---

[1] The Charles Schwab Corporation (NYSE: SCHW) is a leading provider of financial services, with 33.3 million active brokerage accounts, 2.2 million corporate retirement plan participants, 1.6 million banking accounts, and $7.8 trillion in client assets as of January 31, 2022. Through its operating subsidiaries, the company provides a full range of wealth management, securities brokerage, banking, asset management, custody, and financial advisory services to individual investors and independent investment advisors. Its broker-dealer subsidiaries, CS&Co, TD Ameritrade, Inc., and TD Ameritrade Clearing, Inc., (members SIPC, https://www.sipc.org), and their affiliates offer a complete range of investment services and products including an extensive selection of mutual funds; financial planning and investment advice; retirement plan and equity compensation plan services; referrals to independent, fee-based investment advisors; and custodial, operational and trading support for independent, fee-based investment advisors through Schwab Advisor Services. Its primary banking subsidiary, Charles Schwab Bank, SSB (member FDIC and an Equal Housing Lender), provides banking and lending services and products. More information is available at https://www.aboutschwab.com.

[2] Exchange Act Release No. 96493, 88 Fed. Reg. 3786 (Jan. 20, 2023) ("Rule 605 Proposal").

Overview

The SEC notes in the proposal that differences in broker-dealers' 605 reports "may be more reflective of differences in business models rather than effectiveness in achieving execution quality for covered orders because of differences in order handling practices." This concern is more pronounced for the proposed "Summary Report" as compared to the proposed "Detailed Report", as the Summary Report will not contain the granular groupings that reveal important order flow differences—notably symbol, order size, and order type. If differences in Summary Report statistics are a result of different business models across firms rather than actual differences in execution quality, providing information that appears to be—but is not—a direct comparison could mislead investors rather than provide comprehensive information necessary on which to base decisions. Since the Summary Report is the most likely of the two reports to be consumed by the individual investor, the stakes are the highest here to get it right. Therefore, we will primarily focus on the Summary Report, but will also have suggestions on how to improve the utility of the Detailed Report.

Summary Report

The Summary Report Should Include Additional Descriptive Statistics

The Summary Report needs additional descriptive statistics showing order flow attributes that can affect the comparability of execution quality statistics to enable a more accurate and useful measure of execution quality. The data utilized by the Commission in its proposals illustrates that, among other factors, Price Impact and Quoted Spread have a strong relationship with Effective/Quoted ("E/Q"). For example, in the Commission's Order Competition Proposal,[3] the Commission notes in Table 15 that "the retail broker's adverse selection risk (as measured by the coefficient on the Broker-Dealer Average Price Impact variable) has a statistically significant effect on the execution quality wholesalers give on trades they internalize."[4] Table 3 of the Commission's Rule 605 Proposal illustrates that wholesalers provide better execution quality to brokers that send order flow with less adverse selection [risk], as measured by price impact.[5]

These studies demonstrate that retail brokers have vastly different client bases reflected in vastly different order flow characteristics, which affects execution quality. These differences need to be reflected in the Summary Report so that the individual investor has sufficient data to make an educated assessment of the execution quality performance between different brokers. Schwab proposes the following metrics to be added to the Summary Report to enable investors to accurately compare execution quality between different brokers.

[3] Exchange Act Release No. 96495, 88 Fed. Reg. 128 (January 3, 2023)("Order Competition Proposal").
[4] 88 Fed. Reg. 200.
[5] 88 Fed. Reg. 3839.

Average Notional Order Size

The Summary Report would provide more accurate information to investors on the mix of order flow by including the Average Notional Order Size. This metric is measured by multiplying the number of shares by the midpoint at the time of order entry. Schwab assumes that the Average Order Size proposed in the report is expected to be in shares (though it is not specified in the proposal). We believe that average order size in shares and average order size in notional value are complementary metrics that will allow individual investors, market data analytics professionals, and academics to assess the broker in the context of important order flow attributes. The inclusion of both metrics will also allow the user of the report to calculate Average Price Per Share by dividing Average Notional Order Size by Average Share Order Size. Average Price Per Share is an important metric as it is the same as the share-weighted average midpoint price, which is the denominator of the "Percentage" metrics. Since a broker's average order size can impact its average execution quality metrics, providing this transparency to users of the Summary Report will mitigate the potential for misinterpretation of the data and better inform individual investors when they compare brokers.

Percentage Realized Spread

As noted above, Price Impact can significantly affect E/Q, and users of the Summary Report should, therefore, be able to view a broker's execution quality numbers in the context of this metric. Price Impact can be calculated as the difference between the Effective Half-Spread and the Realized Half-Spread. Percentage Effective Spread is already included in the Summary Report, and if Percentage Realized Spread were added, then the user could derive Percentage Price Impact. Percentage Realized Spread is calculated by dividing Realized Spread by the midpoint of the NBB and NBO at the time of order entry. This simple addition would provide better transparency regarding the distinct characteristics of order flow among brokers which, in turn, affects the average execution quality metrics on the reports. Omitting important information like this from the reports would contribute to inaccurate conclusions and runs counter to the goals of this proposal and market participant expectations for a fair and transparent market.

Percentage Quoted Spread

The Commission's Order Competition Proposal analysis also indicated that a broker's Average Quoted Spread can significantly affect E/Q. Therefore, users of the Summary Report should be afforded the opportunity to review differences in broker Average Quoted Spread. Staying consistent with how the other spread metrics are proposed to be expressed in percentage terms, we propose that Quoted Spread be expressed as Percentage Quoted Spread. Percentage Quoted Spread is calculated by dividing Quoted Spread by the midpoint of the NBB and NBO at the time of order entry. In addition to providing transparency into the mix of each broker's order flow, including this metric will allow users to confirm the E/Q calculation on the Summary Report by dividing Percentage Effective Spread by Percentage Quoted Spread. Importantly, the E/Q result of this calculation would be different from the E/Q result of the Commission's proposed calculation, a point we will detail below.

The Summary Report Should Focus on Orders Under $200,000

In both studies referenced above, the Commission limited their scope of retail order flow to orders of less than $200,000. This was done to normalize order flow variables for analysis in order to meaningfully compare broker-dealers' execution quality. Likewise, consistent with Commission's studies, the report should limit the orders in the report to those for less than $200,000, which is a natural breakpoint between size categories.

Effective/Quoted (E/Q) Aggregation

Effective/Quoted is a common metric used within the industry to judge execution quality because it provides a normalized comparison of price improvement relative to the price improvement opportunity. The quoted spread dictates the price improvement opportunity. The best price that could be reasonably expected by an investor is midpoint between the NBBO, which results in an E/Q of zero, while a fill at the far touch results in an E/Q of 100.

The industry, however, recognizes that to calculate an aggregate E/Q across orders, it must use a spread-weighted approach, which normalizes E/Q for aggregate price improvement opportunity and allows one to preserve the ability to calculate the total amount of price improvement if one also knows the effective spread and number of shares traded. The Commission proposes to calculate an E/Q for each order, and then share-weight E/Q from there. Share-weighting, however, becomes meaningless once you aggregate the metric across stocks. Share-weighting loses the intelligibility of E/Q by detaching from it the ability to understand it in the context of the opportunity for price improvement. Schwab believes this misrepresents aggregate E/Q and opens the door for possible manipulation of the results. Strict share-weighting would create the perverse incentive for market centers to provide more improvement on narrow spread securities and less price improvement on widespread securities, an outcome that is the exact opposite of promoting positive market quality.

The Summary Report Should Be Derivable from the Detailed Report

As noted in our previous letter regarding the Commission's market structure proposals, Schwab believes there should be consistency between the proposed report and its more granular Detailed Report. Unfortunately, as proposed, this consistency does not exist. For example, if one wanted to aggregate the Percentage Effective Spread in the Detailed Report and compare it to the Summary Report, one would see different results. The reason for this inconsistency is because the Detailed Report does not include a field for Notional Order Value (midpoint of NBBO times shares) or Average Price Per Share. Notional Order Value must be used for aggregation because the denominator of Percentage Effective Spread is Notional Order Value by way of Average Price Per Share. Inconsistent outcomes as described above may be avoided by ensuring that the Detailed Report includes Notional Order Value or Average Price Per Share, allowing one to calculate Summary Report percentage metrics from the Detail Report metrics.

Additionally, no definition exists in the proposal for the metric Average Percentage Price Improvement Per Order. Perhaps one could assume that this is the sum of price improvement divided by the sum of notional value. If that is the case, then this is another Summary Report metric that cannot be derived from the Detailed Report. However, the words “per order” do not make sense in this context, so the Commission’s intent is unclear.

Other Suggestions

The Reports Should Use Order Route Time, Not Order Receipt Time

Schwab believes the reports should use Order Route Time, not Order Receipt Time, for non-market centers to allow for the fact that brokers perform necessary review activities following receipt of the order, but prior to routing the order. Current Rule 605 reports require that the Order Receipt Time be the benchmark time for determining marketability and quote-based metrics. This standard may be appropriate for evaluating market centers; however, order receipt time is not an appropriate trigger for non-market center reporting venues who will be required to provide reporting under the proposal.

The use of order receipt time rather than route time would result in some execution quality statistics like execution speed not being fairly represented in the reports due to outliers caused by market access review activities. Routing brokers are required to have market access and fraud surveillance controls in place, and some brokers’ order flow requires more orders to pass through a review queue than others. This is an especially important issue for the report, which only requires execution speed to be measured as a share-weighted average. By nature, larger share orders will be more likely to be sent to a review queue, and due to their size, have a disproportionate negative impact on average execution speed. Consequently, using order receipt time could create a perverse incentive for firms to diminish time spent on necessary reviews in an effort to improve execution speed statistics.

If the Commission’s goal is to provide individual investors with the information needed to fairly evaluate brokers’ execution quality, then route time, instead of receipt time, should be the benchmark for non-market centers in Rule 605 reports.

Execution speed for marketable limit orders

Additionally, the execution speed metric for marketable limit orders should be limited to the size available at the best protected quote at the far touch. This will ensure that orders larger than the quoted size that take out the best price and then are reflected for the balance do not skew the statistics.

The Detailed Report Should Exclude Stop Orders

The Detailed Report should exclude stop orders to avoid confusion. The Commission’s proposed definition of executable stop order runs counter to how stop orders actually become executable, and therefore, would create misleading information in the report. The proposal states that, "for any buy order submitted with a stop price, that the stop price is equal to or greater than the national best bid during regular trading hours, and, for any sell orders submitted with a stop price, that the stop price is equal to or less than the national best offer during regular trading hours". However, FINRA Rule 5350 defines a stop order as "an order to buy (or sell) that becomes a market order to buy (or sell) when a transaction occurs at or above (below) the stop price." By rule, broker-dealers may elect to trigger a stop order in a different fashion but are prevented from calling it a "stop order." The most common other trigger condition on a sell stop is the bid, but very rarely do equity sell stop orders trigger off the ask. An alternative approach would be for the Commission to consider a stop order "executable" when the order's condition has been met.

Additionally, stop orders can have at least three distinct behaviors after they are triggered—market order, marketable limit order, or non-marketable limit order. A more transparent way to include these orders would be to create three separate categories of stop orders reflecting these triggers. However, all this considered will create increased complexity with little benefit for the individual investor, so the Commission should consider excluding stop orders from the report entirely and allow firms to further disclose the relevant details to their clients in a manner consistent with their trading experience.

The Detailed Report Should Exclude Best Available Displayed Price

The Detailed Report should exclude Best Available Displayed Price because this metric is only relevant on a small number of occasions and would add misleading information to the report. The Commission proposes adding five metrics using "best available displayed price." However, the Commission cited a recent academic working paper showing that odd-lots offer better prices than the NBBO 18% of the time for bids and 16% of the time for offers. Further, when the MDI's new round lot definitions take effect, the percent of the time "best available price" differs from the NBBO will be even smaller. If it is only relevant a small part of the time, and it fails to provide context into how many shares are included in the price or how many shares the order was for, the "best available displayed price" metrics will border on being meaningless and add unnecessary complexity to the report.

In addition, any data relating to the "best available displayed price" should not be included in the report format until the best odd-lot order to buy and best odd-lot order to sell have been included in the SIP.

Non-Marketable Limit Orders ("NMLOs") Should be Simplified

The Detailed Report's beyond-the-midpoint limit order category adds potentially misleading information, as it is not a large category today, and will become de minimis with the Market Data Infrastructure ("MDI") round lot definitions (and if the Commission's tick proposal is adopted). Retail investors are less able to compete with market professionals on the quote with narrow quoted spreads and granular tick increments. This will result in fewer NMLOs, and even fewer beyond-the-midpoint limit orders. The Commission argues that beyond-the-midpoint orders have both characteristics of marketable orders and NMLOs. However, the fact that the limit order's price between the midpoint and far touch (exclusive) is a variable controlled by the individual investor—and is responsible for some of its "price improvement"—would create statistics related to marketable orders that cannot be compared across market centers and brokers.

The Commission should also exclude NMLOs entered outside normal hours, as these will likely skew the statistics for NMLOs entering during trading hours. Frequently, the first quote after opening is wide and not representative of the quote when the primary exchange opens. Many orders deemed NMLOs by this benchmark will likely fill as soon as the primary exchange opens. Therefore, including these orders will skew the NMLO stats and lead to difficult comparisons between brokers. Including NMLOs entered outside market hours may be akin to including stop market orders in the market order category, as they are filled under very different circumstances from the other orders in the category.

Conclusion

As we have asserted in our previous comment letters, we remain concerned that the Commission has simultaneously issued multiple far-reaching proposals that would dramatically overhaul current market structure without adequately assessing the cumulative impact on the market or the potential for unintended consequences.[6] The SEC should pursue a prudent approach by implementing the changes to Rule 605, including our recommendations, and evaluate the data and the state of the market before proceeding further. Indeed, 32 bipartisan members of the U.S. House of Representatives recently urged Chair Gensler to proceed with precisely this approach, highlighting their concerns for potential unintended consequences that we believe could jeopardize the efficiency of our markets, capital formation, and broad investor participation that allows proactive management of their financial future.[7]

We believe that comprehensive and accurate data is critical to enabling both regulators and market participants to assess the impact of any other changes made to current market structure. We remain eager to engage in productive initiatives that will improve our markets and outcomes for investors, driven by data and calibrated to reduce unintended consequences. We hope that our views and those of 32 members of Congress will be carefully considered by the Commission, and we look forward to a continuing dialogue with the Commission and the staff

---

[6] *See* Letters re: Equity Market Structure Proposals, from NYSE Group, Inc., Charles Schwab & Co., and Citadel Securities to Vanessa Countryman, Secretary, Securities & Exchange Commission (March 6, 2023) and Charles Schwab & Co. to Vanessa Countryman, Secretary, Securities & Exchange Commission (March 31, 2023).

[7] *See* Letter from U.S. House of Representatives Bill Foster, French Hill, Henry Cuellar, Bill Huizenga, Wiley Nickel, Andy Barr, Ritchie Torres, Ann Wagner, Brittany Pettersen, Dan Meuser, Josh Gottheimer, Mike Flood, Vicente Gonzalez, Byron Donalds, Mike Quigley, Michael V. Lawler David Scott, Andrew R. Garbarino, Gregory W. Meeks, Monica De La Cruz, Sean Casten, Scott Fitzgerald, Bradley S. Schneider, Erin Houchin, Jim Himes, Young Kim, Steven Horsford, Ralph Norman, Gwen S. Moore, Tom Emmer, Marc Veasey, and Zach Nunn to Gary Gensler, Chair, Securities & Exchange Commission (September 26, 2023).

regarding any future modifications to the U.S. equity markets.

Schwab greatly appreciates the opportunity to submit these additional comments. If you have any questions or require additional information, please do not hesitate to contact us.

Sincerely,

Jason Clague
Managing Director, Head of Operations
The Charles Schwab Corporation

Cc. The Hon. Gary Gensler, Chair
The Hon. Hester M. Peirce, Commissioner
The Hon. Caroline A. Crenshaw, Commissioner
The Hon. Mark T. Uyeda, Commissioner
The Hon. Jaime Lizárraga, Commissioner
Haoxiang Zhu, Director, Division of Trading & Markets
David Saltiel, Deputy Director, Division of Trading & Markets
Andrea Orr, Deputy Director, Division of Trading & Markets
David Shillman, Associate Director, Division of Trading & Markets
Eric Juzenas, Associate Director, Division of Trading & Markets
Jessica Wachter, Chief Economist and Director, Division of Economic and Risk Analysis