

**NOVEMBER 2015  
FOIA FILE**

**42**

**TOTAL DOCUMENTS**

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for November 2015, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY JO WHITE, CHAIR

LUIS A. AGUILAR, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

KARA M. STEIN, COMMISSIONER

MICHAEL S. PIWOWAR, COMMISSIONER

(9 Documents)

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
Release No. 76333 / November 3, 2015

**INVESTMENT ADVISERS ACT OF 1940**  
Release No. 4255 / November 3, 2015

**ADMINISTRATIVE PROCEEDING**  
File No. 3-16939

**In the Matter of**

**PATRICIA S. MILLER,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 15(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
AND SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Patricia S. Miller ("Miller" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over her and the subject matter of these proceedings, and the findings contained in Section III.2. below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Miller, age 69, is currently incarcerated in federal prison located in Alderson, West Virginia. From July 2010 through May 2014, she was a registered representative associated with Investors Capital Corp., a registered broker-dealer and registered investment adviser. From February 1996 through July 2010, Miller was a registered representative associated with Janney Montgomery Scott, LLC, and from August 1992 through February 1996, she was a registered representative associated with Advest, Inc. Each of those firms is also dually registered with the Commission as a broker-dealer and investment adviser.

2. On December 17, 2014, Miller pled guilty to five counts of wire fraud in violation of 18 U.S.C. §1343 before the United States District Court for the District of Massachusetts in United States v. Patricia S. Miller, 1-14-cr-10185-LTS-1. On March 31, 2015, a judgment of conviction was entered against Miller sentencing her to a prison term of 72 months followed by three years of supervised release and imposing a forfeiture money judgment in the amount of at least \$2.5 million.

3. The counts of the criminal indictment to which Miller pled guilty alleged, *inter alia*, that from approximately January 2002 through May 2014, Miller defrauded customers and obtained over \$2.5 million in money and property by means of materially false and fraudulent pretenses, representations and promises concerning purported investments that she never made on behalf of her customers. Miller furthered her scheme by transmitting wire communications in interstate commerce.

### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Miller's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act, and Section 203(f) of the Advisers Act, that Respondent Miller be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

Pursuant to Section 15(b)(6) of the Exchange Act Respondent Miller be, and hereby is barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any

disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: Jill M. Peterson  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**

**Release No. 76358 / November 5, 2015**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-16942**

**In the Matter of**

**Friendly Energy Exploration,  
Public Media Works, Inc.,  
VRDT Corp., and  
Zoro Mining Corp.,**

**Respondents.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
AND NOTICE OF HEARING  
PURSUANT TO SECTION 12(j) OF  
THE SECURITIES EXCHANGE ACT  
OF 1934**

**I.**

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Friendly Energy Exploration, Public Media Works, Inc., VRDT Corp., and Zoro Mining Corp.

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Friendly Energy Exploration (CIK No. 1120434) is a revoked Nevada corporation located in Carson City, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Friendly Energy Exploration is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2012, which reported a net loss of \$5,704,152 from the company's February 11, 2005 inception to December 31, 2012. As of October 26, 2015, the company's stock (symbol "FEGR") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Public Media Works, Inc. (CIK No. 1108730) is a void Delaware corporation located in Los Angeles, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Public Media Works is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended November 30, 2012, which reported a net loss of \$41,890 for the prior nine months. As of October 26, 2015, the company's stock (symbol "PUBQQ") was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. VRDT Corp. (CIK No. 1399480) is a void Delaware corporation located in Rancho Cucamonga, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). VRDT is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2012, which reported a net loss of \$2,072,749 for the prior nine months. As of October 26, 2015, the company's stock (symbol "VRDT") was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Zoro Mining Corp. (CIK No. 1329484) is a revoked Nevada corporation located in Tucson, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Zoro Mining is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended January 31, 2013, which reported a net loss of \$26,401,464 from the company's April 20, 2004 inception to January 31, 2013. As of October 26, 2015, the company's stock (symbol "ZORM") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

## B. DELINQUENT PERIODIC FILINGS

5. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

6. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

7. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

### III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

### IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: Jill M. Peterson  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**

**Release No. 76378 / November 6, 2015**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-16947**

**In the Matter of**

**Inelco Corp., and  
Telephone Corp.,**

**Respondents.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
AND NOTICE OF HEARING  
PURSUANT TO SECTION 12(j) OF  
THE SECURITIES EXCHANGE ACT  
OF 1934**

**I.**

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Inelco Corp. and Telephone Corp.

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Inelco Corp. (CIK No. 1427352) is a revoked Nevada corporation located in Coral Springs, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Inelco is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2013, which reported a net loss of \$5,528,948 from the company's December 31, 2007 inception to June 30, 2013. As of October 26, 2015, the company's stock (symbol "INLC") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Telephone Corp. (CIK No. 1101783) is a Nevada corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the

Commission pursuant to Exchange Act Section 12(g). Telephone is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2013, which reported a net loss of \$432,470. As of October 26, 2015, the company's stock (symbol "TLPH") was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

#### B. DELINQUENT PERIODIC FILINGS

3. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

4. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

5. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

### III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

### IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**

**Release No. 76404 / November 10, 2015**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-16953**

**In the Matter of**

**Echelon Acquisition Corp. and  
FirstChina Capital, Inc.,**

**Respondents.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
AND NOTICE OF HEARING  
PURSUANT TO SECTION 12(j) OF  
THE SECURITIES EXCHANGE ACT  
OF 1934**

**I.**

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Echelon Acquisition Corp. and FirstChina Capital, Inc.

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Echelon Acquisition Corp. (CIK No. 1100379) is a void Delaware corporation located in Washington, D.C. with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Echelon Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on December 16, 1999.

2. FirstChina Capital, Inc. (CIK No. 1135344) is a dissolved New York corporation located in Kew Garden Hills, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FirstChina Capital is

delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on March 13, 2001.

#### B. DELINQUENT PERIODIC FILINGS

3. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

4. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

5. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

### III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

### IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**

**Release No. 76426 / November 12, 2015**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-16954**

**In the Matter of**

**Riverdale Mining Inc., and  
Tresoro Mining Corp.,**

**Respondents.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
AND NOTICE OF HEARING  
PURSUANT TO SECTION 12(j) OF  
THE SECURITIES EXCHANGE ACT  
OF 1934**

**I.**

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Riverdale Mining Inc. and Tresoro Mining Corp.

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Riverdale Mining Inc. (CIK No. 1402357) is a revoked Nevada corporation located in Toronto, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Riverdale Mining is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2012, which reported a net loss of \$873,951 from the company's March 30, 2007 inception to December 31, 2012. As of November 3, 2015, the company's stock (symbol "RVDM") was quoted on OTC Link, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Tresoro Mining Corp. (CIK No. 1348788) is a defaulted Nevada corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Tresoro Mining is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended November 30, 2012, which reported a net loss of \$33,342,737 from the company's October 11, 2004 inception to November 30, 2012. As of November 3, 2015, the company's stock (symbol "TSOR") was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

#### B. DELINQUENT PERIODIC FILINGS

3. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

4. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

5. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

### III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

### IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and

place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By **Jill M. Peterson**  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4265 / November 13, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16958**

**In the Matter of**

**OSCAR WU,**

**Respondent.**

**ORDER INSTITUTING**  
**ADMINISTRATIVE PROCEEDINGS**  
**PURSUANT TO SECTION 203(f) OF THE**  
**INVESTMENT ADVISERS ACT OF 1940,**  
**MAKING FINDINGS, AND IMPOSING**  
**REMEDIAL SANCTIONS**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Oscar Wu ("Respondent").

**II.**

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions (the "Order"), as set forth below.

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### III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Oscar Wu, age 46, was a portfolio manager for a registered investment adviser based in New York, New York from March 2011 until April 2013.

2. On October 26, 2015, a final judgment was entered by consent against Respondent, permanently enjoining him from future violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Oscar Wu, 1:15-cv-07922-KMW, in the United States District Court for the Southern District of New York.

3. The Commission's complaint alleged that Respondent, knowingly or recklessly, traded on and tipped material non-public information in breach of duties he owed to his former investment adviser employer and to the shareholders of the company his former employer advised.

4. Specifically, the Commission's complaint alleged that, in the course of his employment as a portfolio manager for his former employer, Wu learned material, non-public information about a planned patent acquisition and revenue-sharing agreement between two prominent telecommunications companies. The Commission alleged that Wu used this information to place trades in the account of a relative, thereby generating \$9,469 in illegal profits, and then also tipped another relative, who traded in her own account, generating \$7,440 in illegal profits.

### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act, that Respondent be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization with the right to apply for reentry after five years to the appropriate self-regulatory organization, or if there is none, to the Commission.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
Assistant Secretary

*Commissioner Aguilar  
Not participating*

**UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940  
Release No. 4267 / November 16, 2015**

**ADMINISTRATIVE PROCEEDING  
File No. 3-16961**

**In the Matter of  
  
CHRIS YOO,  
  
Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Chris Yoo ("Respondent" or "Yoo").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

**III.**

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Yoo (CRD # 3136504) was the Chief Executive Officer, Chief Investment Officer, and majority owner of Summit Asset Strategies Investment Management, LLC ("Investment Management"). Yoo, through Investment Management, controlled and made investment decisions for two private funds, Summit Stable Value Fund ("SSVF") and Summit Stable Opportunities Fund I ("SSOP I"), for compensation. Yoo, 42, resides in Medina, Washington.

2. On November 6, 2015, a final judgment was entered by consent against Yoo, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-8 thereunder, in the civil action entitled Securities and Exchange Commission v. Summit Asset Strategies Investment Management, LLC et al., Civil Action Number 2:15-cv-01429-RAJ, in the United States District Court for the Western District of Washington.

3. The Commission's complaint alleged that, in connection with first fund (SSVF), Yoo (i) misappropriated investor funds, (ii) materially overstated the values of the fund's assets in financial statements that were provided to existing investors, and (iii) solicited new investments using offering documents that contained false and misleading information regarding the manner in which Yoo purported to withdraw management fees. The complaint also alleged that Yoo misled investors in the second fund (SSOP I) by concentrating the fund's investments in a single issuer (SSVF) in a manner that was inconsistent with prior disclosure to SSOP I's investors and that Yoo failed to correct the earlier disclosure or otherwise disclose the fund's concentrated investment.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Yoo's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act, that Respondent Yoo be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**

**Release No. 76448 / November 16, 2015**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-16962**

**In the Matter of**

**Equity Ventures Group, Inc., and  
Games on Demand International, Inc.  
(a/k/a Firmware Technologies Inc.),**

**Respondents.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
AND NOTICE OF HEARING  
PURSUANT TO SECTION 12(j) OF  
THE SECURITIES EXCHANGE ACT  
OF 1934**

**I.**

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Equity Ventures Group, Inc. and Games on Demand International, Inc. (a/k/a Firmware Technologies Inc.).

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Equity Ventures Group, Inc. (CIK No. 1298327) is a dissolved Florida corporation located in Fort Lauderdale, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Equity Ventures Group, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2010, which reported a net loss of \$16,763 for the prior nine months.

2. Games on Demand International, Inc. (a/k/a Firmware Technologies Inc.) ("Games on Demand") (CIK No. 1324637) is a void Delaware corporation located in Plantation, Florida with a class of securities registered with the Commission pursuant to

Exchange Act Section 12(g). Games on Demand is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on April 25, 2005.

## B. DELINQUENT PERIODIC FILINGS

3. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

4. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

5. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

## III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

## IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**

**Release No. 76476 / November 19, 2015**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-16965**

**In the Matter of**

**African Copper Corp.,  
Genmed Holding Corp., and  
Yanglin Soybean, Inc.,**

**Respondents.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
AND NOTICE OF HEARING  
PURSUANT TO SECTION 12(j) OF  
THE SECURITIES EXCHANGE ACT  
OF 1934**

**I.**

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents African Copper Corp., Genmed Holding Corp., and Yanglin Soybean, Inc.

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. African Copper Corporation (CIK No. 1526185) is a revoked Nevada corporation located in Mowbray, Cape Town, South Africa with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). African Copper is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended January 31, 2013, which reported a net loss of \$189,977 from the company's April 6, 2011 inception to January 31, 2013. As of November 10, 2015, the company's stock (symbol "ACCS") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Genmed Holding Corp. (CIK No. 1061688) is a revoked Nevada corporation located in Zoetermeer, The Netherlands with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Genmed Holding is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2012, which reported a net loss of \$1,429,690 for the prior twelve months. As of November 10, 2015, the company's stock (symbol "GENM") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Yanglin Soybean, Inc. (CIK No. 1368745) is a revoked Nevada corporation located in Heilongjiang Province, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Yanglin Soybean is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2012, which reported a net loss of \$20,544,333 for the prior nine months. As of November 10, 2015, the company's stock (symbol "YSYB") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

#### B. DELINQUENT PERIODIC FILINGS

4. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

5. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

6. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

### III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each

class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

#### IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields  
Secretary

By: *William M. Peterson*  
William M. Peterson  
Assistant Secretary

美利坚合众国  
呈交  
证券交易委员会 (SECURITIES AND EXCHANGE COMMISSION)

1934年证券交易法 (SECURITIES EXCHANGE ACT OF 1934)

发行编号

行政诉讼

备案号

关于

非洲科珀公司 (African Copper Corp.)、  
杰美德控股公司 (Genmed Holding  
Corp.) 和  
阳霖油脂集团 (Yanglin Soybean, Inc.)，

答辩人

依照节(j)条启动行政诉讼和发布听证会  
公告之命令

I.

证券交易委员会 (以下简称为“委员会”)认为,为了保护投资者,依照《1934年证券交易法》(以下简称为“交易法”)第12节(j)条对答辩人非洲科珀公司 (African Copper Corp.)、杰美德控股公司 (Genmed Holding Corp.) 以及阳霖油脂集团 (Yanglin Soybean, Inc.) 提起公共行政诉讼是必要且适当的。

II.

经调查, 执法司 (Division of Enforcement) 指称:

A. 答辩人

1. 非洲科珀公司 (African Copper Corporation) (CIK 号码: 1526185) 位于南非开普敦的 Mowbray, 是一家已被吊销的内华达州 (Nevada) 公司。该公司根按照交易法第12节(g)条规定在委员会注册了一类证券。非洲科珀 (African Copper) 没有定期向委员会提交报告。在提交了截至2013年1月31日止的10-Q表格 (该公司在此表格上报告从2011年4月6日成立以来到2013年1月31日的净亏损为189,977美元) 后, 该公司未再向委员会提交过任何定期报告。截至2015年10月26日止, 该公司股票 (股票代码为“ACCS”) 仍在场外交易市场

集团 (OTC Markets Group, Inc.) 运作的“场外交易链接 (OTC Link)” (原为“粉单市场 (Pink Sheets)”) (以下简称为“场外交易链接”) 上挂牌交易, 拥有七家做市商, 并且符合交易法第 15c2-11(f)(3)条规则中“捎带” (piggyback)例外的资格。

2. 杰美德控股公司 (Genmed Holding Corp.) (CIK 号码: 1061688) 位于荷兰的 Zoetermeer, 是一家已被撤销的内华达州公司。该公司按照交易法第 12 节 (g)条规定在委员会注册了一类证券。杰美德控股 (Genmed Holding) 没有定期向委员会提交报告。在提交了截至 2012 年 12 月 31 日止的 10-K 表格 (该表格称前 12 个月公司净亏损为 1,429,690 美元) 后, 该公司未再向委员会提交过任何定期报告。截至 2015 年 10 月 26 日止, 该公司股票 (股票代码为“GENM”) 仍在“场外交易链接”上挂牌交易, 拥有六家做市商, 并且符合交易法第 15c2-11(f)(3)条规则中“捎带”例外的资格。

3. 阳霖油脂集团 (Yanglin Soybean, Inc.) (CIK 号码: 1368745) 位于中国黑龙江省, 是一家已被撤销的内华达州公司。该公司按照交易法第 12 节(g)条规定在委员会注册了一类证券。阳霖油脂 (Yanglin Soybean) 没有定期向委员会提交报告。在提交了截至 2012 年 12 月 31 日止的 10-K 表格 (该表称公司前九个月净亏损为 20,544,333 美元) 后, 该公司未再向委员会提交过任何定期报告。截至 2015 年 10 月 26 日止, 该公司股票 (股票代码为“YSYB”) 仍在“场外交易链接”上挂牌交易, 拥有六家做市商, 并且符合交易法第 15c2-11(f)(3)条规则中“捎带”例外的资格。

#### B. 没有定期提交报告

4. 正如上文详述, 三名答辩人没有定期向委员会提交报告, 屡次未履行其应及时提交定期报告的义务, 并且忽略企业财务司 (Division of Corporation Finance) 发出的拖欠函, 要求其遵守定期提交报告的义务, 或因其未遵守委员会关于在委员会档案中保留有效地址的规定而未收到此类信函。

5. 交易法第 13 节(a)条及据此颁布的规则要求按照交易法第 12 节注册的证券发行者必须以提交定期报告的形式向委员会提供最新的和准确的信息, 即使是按照第 12 节(g)条规定自愿注册的也要提交。具体而言, 第 13a-1 条规则要求发行者提交年度报告, 而第 13a-13 条规则要求国内发行者提交季度报告。

6. 基于上述原因, 答辩人未遵守交易法第 13 节(a)条以及据此制定的第 13a-1 条规则和/或第 13a-13 条规则的规定。

### III.

鉴于执行司提出的指控, 该委员会认为, 为保护投资者而提起公共行政诉讼是必要且适当的, 以据此决定:

A. 本文件第二节中提到的指控是否属实，以及与此相关的，给答辩人一个机会以对指控提出抗辩；而且，

B. 为保护投资者，暂停其证券登记是否有必要且适当的，期间不超过十二个月，或撤销在本文件第二节中提到的答辩人依交易法第 12 节所登记注册的每一类证券，以及撤销任何以交易法规则 12b-2 或 12g-3 定义下之继任者名义和以答辩人任何新公司名称所登记注册的每一类证券。

#### IV.

兹在此下令，为对本文件第三节所述问题进行取证，应在指定时间和地点举行公开听证会。此听证会应在行政法法官前举行。按照委员会《实务规则》

(Rules of Practice) 第 110 条规则[《美国联邦法规》(C.F.R) 第 17 卷第 201.110 节]规定，将另发命令来指派行政法法官。

兹在此进一步下令，答辩人应按照委员会《实务规则》第 220(b)条规则 [《美国联邦法规》第 17 卷第 201.220(b)节]规定，在本命令送达后 10 天内，对本命令中含载的指控提交答辩。

按照委员会《实务规则》第 155(a)条规则、第 220(f)条规则、第 221(f)条规则和第 310 条规则[《美国联邦法规》第 17 卷第 201.155(a)节、第 201.220(f)节、第 201.221(f)节和第 201.310 节]规定，如果答辩人未提交规定的答辩或在被及时通知后未出席听证会，那么答辩人、根据交易法第 12b-2 条规则或第 12g-3 条规则定义下的的任何继承人以及答辩人名下的任何新公司有可能被视为失职方，诉讼结果可能会因本命令被纳入考虑而对答辩人不利，而且命令中的指控可能会被视为属实。

本命令应当立即送达答辩人本人或以保证邮件、挂号信、快件或委员会《实务规则》允许的其他方式送至答辩人。

兹在此进一步下令，根据委员会《实务规则》第 360(a)(2)条规则[《美国联邦法规》第 17 卷第 201.360(a)(2)节]规定，行政法法官应在本命令送达日算起 120 天内做出初始裁决。

如果没有适当的豁免书，任何在本诉讼程序中担任调查或起诉职能的委员会官员或雇员，或是任何在与本诉讼程序事实相关的诉讼程序中担任调查或起诉职能的委员会官员或雇员，除了根据通知在诉讼程序中作为证人或律师以外，均不可参与本程序的决策或对本程序提出建议。由于本程序不是行政程序法 (Administrative Procedure Act) 第 551 节所指的“规则制定”，本程序不受第 553 节所限制，任何最终的委员会行动生效日期不可再予延迟。委员会在此提交。

布伦特·菲尔兹 (Brent J. Fields)  
秘书

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for **November 2015**, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY JO WHITE, CHAIR

LUIS A. AGUILAR, COMMISSIONER

KARA M. STEIN, COMMISSIONER

MICHAEL S. PIWOWAR, COMMISSIONER

(33 Documents)

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 76328 / November 2, 2015**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4251 / November 2, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16936**

**In the Matter of**

**JONATHAN WARREN  
BROOKS,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 15(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
AND SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
AND NOTICE OF HEARING**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Jonathan Warren Brooks ("Respondent").

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENT**

1. Respondent, 43 years old, is currently incarcerated in a state correctional institution in Kershaw, South Carolina. He was a registered investment adviser representative of J. Brooks Financial, which was registered as an investment adviser in South Carolina (South Carolina

registration approved in January 2011 and terminated in February 2013) from September 2010 to February 2013. Respondent was a registered representative associated with High Street Securities, Inc., which was registered with the Commission as a broker-dealer (SEC registration number 8-52657 approved in May 2001 and terminated in January 2014) from November 2011 to November 2012; and with Sicom Securities, Inc., which was registered with the Commission as a broker-dealer (SEC registration number 8-33445 approved in April 1985 and terminated in December 2013) from September 2009 to November 2011. Thus, for a portion of the time in which he engaged in the conduct underlying the indictments described below, Respondent was a registered investment adviser representative associated with a state registered investment adviser; and a registered representative associated with two broker-dealers that were then registered with the Commission. Respondent held Series 6, 7, 63, and 65 licenses. During the periods of Brooks' association with Sicom Securities, Inc., the broker-dealer was also registered as an investment adviser with several states.

B. ENTRY OF RESPONDENT'S CRIMINAL CONVICTION

2. On September 18, 2014, Respondent pleaded guilty to three felony counts of securities fraud and two felony counts of forgery in the Court of General Sessions of Aiken County, South Carolina. *The State vs. Jonathan Warren Brooks*, South Carolina case numbers: 2013-GS-02-1175; 2013-GS-02-1176; 2013-GS-02-1318; 2013-GS-02-1803; and 2013-GS-02-1432). On the same day, the court sentenced Respondent to fourteen years in prison followed by five years of probation and ordered him to pay \$6,403,321.07 in restitution. South Carolina's prisoner database showed that Respondent's incarceration began on September 19, 2014.

3. The counts of the criminal indictments to which Respondent pleaded guilty alleged, among other things, that from approximately January 2010 to approximately March 2013, Respondent obtained money by means of willful fraud (including selling investments in a fictional entity, improperly diverting investor funds, and making false representations to the South Carolina Securities Commissioner) and forgery (forging signatures to facilitate money transfers).

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act; and

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent as provided for in the Commission's Rules of Practice.

This Order shall be served upon Respondent as provided for in Rule 141(a)(2)(iv) of the Commission's Rules of Practice, 17 C.F.R § 201.141(a)(2)(iv), by any method specified in paragraph (a)(2) of that rule, or by any other method reasonably calculated to give notice, provided that the method of service used is not prohibited by the law of the foreign country where Respondent may be found.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By **Jill M. Peterson**  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4253 / November 3, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16938**

**In the Matter of**

**Fenway Partners, LLC, Peter  
Lamm, William Gregory  
Smart, Timothy Mayhew, Jr.,  
and Walter Wiacek, CPA,**

**Respondents.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS  
PURSUANT TO SECTIONS 203(e), 203(f)  
AND 203(k) OF THE INVESTMENT  
ADVISERS ACT OF 1940, MAKING  
FINDINGS, AND IMPOSING REMEDIAL  
SANCTIONS AND A CEASE-AND-DESIST  
ORDER**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Fenway Partners, LLC, Peter Lamm, William Gregory Smart, Timothy Mayhew, Jr. and Walter Wiacek, CPA (collectively, "Respondents").

**II.**

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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### III.

On the basis of this Order and Respondents' Offers, the Commission finds<sup>1</sup> that:

#### SUMMARY

1. These proceedings concern the failure by a registered investment adviser, its principals and a senior executive to disclose conflicts of interest to a private equity fund client, as well as material omissions to investors in the fund about payments to affiliates. Respondent Fenway Partners, LLC ("Fenway Partners"), is a private equity fund adviser that was owned and controlled by respondents Peter Lamm ("Lamm") and William Gregory Smart ("Smart") between January 1, 2011 and December 31, 2013 ("Relevant Period"), and Timothy Mayhew, Jr. ("Mayhew") between January 1, 2011 and May 31, 2012. Respondent Walter Wiacek, CPA ("Wiacek") was the firm's Vice President, Chief Financial Officer and Chief Compliance Officer during the Relevant Period.

2. Fenway Partners served as the investment adviser to Fenway Partners Capital Fund III, L.P. ("Fund III"), a private equity fund, during the Relevant Period. Fund III's portfolio was comprised primarily of investments in branded consumer products and transportation/logistics industry companies (each, a "Portfolio Company").

3. Fenway Partners entered into Management Services Agreements (each, an "MSA") with certain Portfolio Companies pursuant to which Fenway Partners received periodic fees for providing management and other services to the Portfolio Company ("monitoring fees"). In accordance with the terms of Fund III's organizational documents, the monitoring fees were offset against the advisory fee paid by Fund III to Fenway Partners.

4. Beginning in December 2011, Fenway Partners, Lamm, Smart, Mayhew and Wiacek (collectively, "Respondents") caused certain Portfolio Companies to terminate their payment obligations to Fenway Partners under their MSAs and enter into agreements (each, a "Consulting Agreement") with Fenway Consulting Partners, LLC ("Fenway Consulting"), an entity affiliated with Fenway Partners and principally owned and operated by Lamm, Smart and Mayhew. Under the Consulting Agreements, Fenway Consulting provided similar services to the Portfolio Companies, often through the same employees as Fenway Partners had under the MSAs. Mayhew was involved solely with respect to one Portfolio Company.

5. Fenway Consulting ultimately received an aggregate of \$5.74 million from the Portfolio Companies during the Relevant Period. However, in contrast to the monitoring fees paid pursuant to the MSAs, the \$5.74 million in Portfolio Company fees paid to Fenway Consulting were not offset against the Fund III advisory fee, resulting in a larger advisory fee to Fenway Partners. The Respondents did not disclose the conflict of interest presented by the termination of

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<sup>1</sup> The findings herein are made pursuant to the Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

monitoring fees pursuant to the MSAs and collection of fees pursuant to the Consulting Agreements. Respondents Fenway Partners, Lamm and Smart also made, and Wiacek caused to be made, material omissions to fund investors concerning the Consulting Agreements.

6. In addition, in January 2012, Fenway Partners, Lamm and Smart asked Fund III investors to provide \$4 million in connection with a potential investment in the equity securities of a Portfolio Company ("Portfolio Company A"), without disclosing that \$1 million of the requested amount would be used to pay an affiliate, Fenway Consulting. Wiacek signed and sent the letter to investors making this request.

7. In June 2012, Fund III sold its equity interest in a second Portfolio Company ("Portfolio Company B"). As part of the transaction, Mayhew and two former Fenway Partners employees were included in Portfolio Company B's cash incentive plan ("CIP") and ultimately received an aggregate of \$15 million from the proceeds of the sale, thereby reducing Fund III's return on its investment in Portfolio Company B. Mayhew and the two former Fenway Partners employees (collectively, the "Fenway CIP Participants") were employees of Fenway Consulting, an affiliated entity, at the time the payments were made, and received the payments as compensation for services almost entirely performed while they were Fenway Partners employees. The Respondents did not disclose the conflict of interest presented by the payments to the Fenway CIP Participants. Respondents Fenway Partners, Lamm and Smart also made, and Wiacek made or caused to be made, material omissions to investors concerning the CIP payments.

8. By virtue of this conduct, Fenway Partners, Lamm, Smart, and Mayhew willfully violated, and Wiacek caused violations of, Section 206(2) of the Advisers Act. In addition, Fenway Partners, Lamm and Smart willfully violated, and Wiacek caused violations of, Section 206(4) of the Advisers Act, and Rule 206(4)-8 promulgated thereunder.

### RESPONDENTS

9. **Fenway Partners, LLC** is a Delaware limited liability company with its principal place of business in New York, New York. It is an investment adviser registered with the Commission since March 30, 2012. According to its initial filing on Form ADV in February 2012, Fenway Partners had \$756 million in assets under management ("AUM"), and its AUM was \$445 million as stated in its most recent amendment as of April 29, 2015. Fenway Partners has served as the investment adviser to three private equity funds, including Fund III.

10. **Peter Lamm** is 64 years old and resides in New York, New York. Lamm has been a Managing Director and member of Fenway Partners since its inception in 1994. During the Relevant Period, Lamm owned at least 25% of Fenway Partners and was a control person of the entity.

11. **William Gregory Smart** is 55 years old and resides in Chatham, New Jersey. Smart has been a Managing Director and member of Fenway Partners since 1999. During the Relevant Period, Smart owned at least 25% of Fenway Partners and was a control person of the

entity. Smart and Lamm constituted the Operating Committee of Fenway Partners during the Relevant Period and, as such, typically made the day-to-day decisions on behalf of the entity.

12. **Timothy Mayhew, Jr.** is 47 years old and resides in New York, New York. Mayhew became a Managing Director and member of Fenway Partners in 2007. Mayhew owned between 25-50% of the firm and was a control person of Fenway Partners during the Relevant Period until his resignation on May 31, 2012, at which point he immediately joined Fenway Consulting.

13. **Walter Wiacek** is 61 years old and resides in Norwalk, Connecticut. Wiacek joined Fenway Partners in 2007 and was the Vice President, Chief Financial Officer and Chief Compliance Officer of Fenway Partners during the Relevant Period. Wiacek received a certificate in public accounting from the State of Connecticut in 1982 and his current status as a CPA with the State of Connecticut is "qualified."

#### RELEVANT ENTITIES

14. **Fenway Consulting Partners, LLC** is a Delaware limited liability company with its principal place of business in New York, New York. It was formed on July 13, 2011. During the Relevant Period, Lamm, Smart and Mayhew owned 84% of Fenway Consulting.

15. **Fenway Partners Capital Fund III, L.P.** is a Delaware limited partnership and private equity investment fund that was formed in 2006. Fenway Partners III, LLC ("Fund III GP"), a Delaware limited partnership owned by Lamm, Smart, Mayhew and other Fenway Partners employees, served as the general partner of the fund, and Fenway Partners served as the fund's investment adviser during the Relevant Period. As of February 2006, Fund III had \$680 million in committed capital. During the Relevant Period, Fund III's portfolio was comprised primarily of branded consumer products and transportation/logistics industry Portfolio Companies.

#### FACTS

##### A. Background

16. The investors in Fund III (each, a "Limited Partner") include pension funds, life insurance companies and large institutional investors. Each Limited Partner committed to contribute a specified amount of capital to Fund III – to be drawn pursuant to periodic capital calls issued by Fenway Partners, on behalf of Fund III – to invest in Portfolio Companies during the fund's investment period, which began in 2006 and lasted six years. Investments in Fund III (in the form of limited partnership interests) are primarily governed by three documents: a Private Placement Memorandum, an Agreement of Limited Partnership and an Investment and Advisory Agreement (collectively, the "Organizational Documents").

17. The Organizational Documents require Fund III to establish an Advisory Board consisting of Limited Partner representatives who are independent from the Fund III GP and its

affiliates, including Fenway Partners. The Fund III Advisory Board has the “authority and responsibility to approve or disapprove” of certain matters, including actions with a “direct and material conflict of interest or risk of such conflict of interest involving [Fund III] or any of the Partners [including Limited Partners,]” as well as Fenway Partners’ proposed valuations of Portfolio Company securities owned by the fund. During the Relevant Period, nine Limited Partner representatives served on the Fund III Advisory Board. The Advisory Board typically met at least quarterly.

18. Under the Organizational Documents, Fenway Partners, the Fund III GP and their affiliates were entitled to certain enumerated compensation from Fund III and the Portfolio Companies, including carried interest and an advisory fee, as well as certain other fees that were required to be offset against the advisory fee.

**B. Failure to Disclose Conflicts of Interest to the Advisory Board Concerning Agreements with Fenway Consulting**

19. Prior to the Relevant Period, Fenway Partners had entered into MSAs with certain Portfolio Companies pursuant to which Fenway Partners received periodic fees for providing management and other services to the Portfolio Company, known as monitoring fees.

20. Pursuant to the Organizational Documents, Fenway Partners offset 80% of monitoring fees received from a Portfolio Company pursuant to an MSA against its advisory fee from Fund III. Thus, for example, when Fenway Partners received \$1 million of monitoring fees from Portfolio Company B in 2010 pursuant to an MSA between Fenway Partners and Portfolio Company B, Fenway Partners reduced the advisory fee payable by Fund III to Fenway Partners by \$800,000.

21. Beginning in December 2011, the Respondents caused four Fund III Portfolio Companies to terminate their payment obligations under existing MSAs with Fenway Partners and, at the same time, enter into Consulting Agreements with Fenway Consulting, an affiliate of Fenway Partners. Wiacek helped ensure that the Portfolio Companies executed the required documentation, including by personally executing the four Consulting Agreements on behalf of Fenway Consulting. Mayhew was involved solely with respect to Portfolio Company B. Under the Consulting Agreements, Fenway Consulting received periodic fees for agreeing to provide services to a Portfolio Company that were similar to the services that Fenway Partners had provided to the Portfolio Company pursuant to the MSAs. In addition, Fenway Consulting often utilized both the same employees (some of whom had moved to Fenway Consulting in the interim) and the same fee structure that Fenway Partners had used under the MSAs.

22. Fenway Partners did not offset the Portfolio Company payments to its affiliate, Fenway Consulting, against Fenway Partners’ advisory fee from Fund III. For example, in December 2011, Mayhew caused Portfolio Company B to terminate its payment obligations pursuant to an MSA with Fenway Partners and enter into a Consulting Agreement with Fenway Consulting. The Consulting Agreement was to be effective as of January 1, 2011, and Mayhew

directed Portfolio Company B personnel to pay Fenway Consulting \$1 million for services provided in 2011. Fenway Partners did not offset the \$1 million paid to Fenway Consulting against Fenway Partners' advisory fee from Fund III.

23. In addition, in December 2012, Fenway Consulting entered into an MSA with another Portfolio Company. Fenway Partners did not offset the Portfolio Company monitoring fee payments to Fenway Consulting against Fenway Partners' advisory fee from Fund III.

24. The Respondents did not disclose the conflict of interest presented by the agreements between the Fund III Portfolio Companies and Fenway Consulting, an affiliate of Fenway Partners owned by its principals, to the Fund III Advisory Board as required by the Organizational Documents and in breach of their fiduciary obligations to their client, Fund III.

25. In addition, the Respondents did not disclose the conflict of interest presented by the fact that the Portfolio Companies had terminated their payment obligations under the MSAs and replaced them with Consulting Agreements – and that, as a result, the Limited Partners would not receive the benefit of an advisory fee offset for such Portfolio Company payments – to the Fund III Advisory Board as required by the Organizational Documents and in breach of their fiduciary obligations to their client, Fund III.

26. The inherent conflict of interest associated with these payments to Fenway Consulting was not disclosed in or otherwise authorized by the Organizational Documents. Fenway Partners could not effectively consent to these payments on behalf of Fund III because it was conflicted as the recipient of the fees was an affiliate of Fenway Partners and Fenway Partners received the benefit of the decision not to offset the Portfolio Company fees paid pursuant to the Consulting Agreements.

27. Fenway Consulting received an aggregate of \$5.74 million under these agreements during the Relevant Period, none of which was offset against Fenway Partners' advisory fee from Fund III.

**C. Material Omissions to Limited Partners Concerning the Agreements with Fenway Consulting**

28. Fenway Partners conducted a meeting of Fund III's Advisory Board on November 7, 2012. Nine Limited Partner representatives attended.

29. Lamm and Smart, in their capacities as the sole members of Fenway Partners' Operating Committee, prepared the message to be delivered to the Limited Partner representatives, and were the only speakers on behalf of Fenway Partners at the meeting.

30. Lamm noted that Mayhew and certain other Fenway Partners employees had been transferred to Fenway Consulting to provide operational and consulting expertise to certain Portfolio Companies. He explained that Fenway Consulting was retained directly by the Portfolio

Companies and that the Portfolio Companies would pay Fenway Consulting's fees and expenses. Lamm and Smart did not, however, disclose that Fenway Partners had terminated the payment obligations under the existing MSAs with the Portfolio Companies; that Fenway Consulting had entered into Consulting Agreements with the same Portfolio Companies and that the same employees were often providing similar services under these agreements; and that Fenway Partners had not and would not offset the Portfolio Company payments to its affiliate, Fenway Consulting, against Fenway Partners' advisory fee from Fund III.

31. Wiacek, on behalf of Fenway Partners, prepared financial statements for Fund III that, pursuant to the Organizational Documents, were required to be prepared in accordance with U.S. generally accepted accounting principles and provided to the Limited Partners. Fenway Partners and Wiacek failed to consider the Portfolio Company payments to Fenway Consulting as related party transactions and therefore did not include them in the related party transaction disclosures in the 2011 and 2012 financial statements that Fenway Partners provided to the Limited Partners. Because Fenway Consulting is an affiliate of Fenway Partners and Fund III, both Fenway Consulting's relationship with the entities and the payments from the Portfolio Companies to Fenway Consulting should have been disclosed as related party transactions in Fund III's financial statements. In 2013, when the Fund III's independent auditor ("Auditor") learned of the Portfolio Company payments to Fenway Consulting, it required Fenway Partners to disclose the relationship with and the payments to Fenway Consulting in its subsequent audited financial statements.

**D. Material Omission to Limited Partners Concerning the Proceeds of the January 6, 2012 Capital Call**

32. In January 2012, Fenway Partners sent a capital call notice ("Notice") to the Limited Partners with respect to Portfolio Company A. The Notice requested that the Limited Partners provide \$4 million to invest in Portfolio Company A securities to be used for capital improvements in the Portfolio Company. In fact, Fund III used \$3 million of the \$4 million to purchase Portfolio Company A securities, and \$1 million to pay Fenway Consulting pursuant to a Consulting Agreement that was executed simultaneously with Fund III's receipt of the capital call proceeds from the Limited Partners.

33. Lamm and Smart reviewed drafts of the Notice and approved the final communication to be sent, on behalf of Fenway Partners, to the Limited Partners.

34. On January 6, 2012, Wiacek signed the Notice and sent it, on Fenway Partners letterhead, to the Fund III Limited Partners.

35. Fenway Partners, Lamm and Smart did not disclose to the Limited Partners in the Notice or otherwise that \$1 million of the January 6, 2012 capital call was used to pay Fenway Consulting.

**E. Failure to Disclose Conflict of Interest to the Advisory Board and Material Omissions to Limited Partners Concerning Cash Incentive Plan Payments to Mayhew and Others**

**i. Background**

36. Mayhew sourced Portfolio Company B as a potential Fund III investment and recommended that the fund acquire an interest in the company. Mayhew and Lamm negotiated on behalf of Fund III to purchase Portfolio Company B securities. Fund III acquired a controlling interest in Portfolio Company B in 2007. After its acquisition, Mayhew and Lamm remained actively involved in Fund III's investment in Portfolio Company B, including by serving on Portfolio Company B's board of directors, with Lamm serving on the compensation committee. In addition, Mayhew served as Chairman of Portfolio Company B and worked with the company's management.

37. In April 2008, Portfolio Company B established a CIP that, according to the authorizing document, was designed to incentivize "members of management and directors who[m] the Board consider[ed] to be in a position to enhance the success" of Portfolio Company B. The Board awarded Units representing potential cash awards upon a sale of the company. From the inception of the plan until June 2012, the participants were almost entirely Portfolio Company B employees; indeed, no Fenway Partners employee or affiliate had been a recipient of a CIP grant prior to June 2012.

38. In 2011, Mayhew and Lamm, on behalf of Fund III, decided to explore the potential sale of Portfolio Company B, and the process accelerated in early 2012.

**ii. Failure to Disclose Conflict of Interest to the Advisory Board**

39. As the likelihood of a sale increased in May 2012, Mayhew advocated to Lamm that he receive compensation for services that he had provided to Portfolio Company B in addition to the compensation that he expected to receive as a member of Fenway Partners or Fund III GP.

40. Lamm relayed Mayhew's request to Smart and advised that he was considering including Mayhew in the CIP to be paid from the proceeds of the sale of the company. Smart agreed, and Lamm informed Mayhew that he would seek to include him in the CIP.

41. Fenway Partners, Lamm, and Mayhew recommended to members of the Portfolio Company B board of directors that Mayhew and two former Fenway Partners employees – who had each resigned from Fenway Partners six months earlier and joined Fenway Consulting – be awarded Units pursuant to the CIP as compensation for services almost entirely performed while they were Fenway Partners employees. As there were not sufficient authorized Units at the time for the Fenway CIP Participants, Fenway Partners, Lamm and Mayhew recommended that Portfolio Company B issue additional CIP Units. This expansion of the CIP reduced Fund III's return from the sale of its Portfolio Company B investment.

42. On June 3, 2012, the board of directors of Portfolio Company B met. Mayhew and Lamm played a prominent role in preparing for the meeting. The board approved the sale and, as part of the transaction, expanded the CIP to issue Units to include the Fenway CIP Participants. Lamm and Mayhew abstained on the vote to award the CIP Units to the Fenway CIP Participants.

43. The Fenway CIP Participants ultimately received \$15 million of the Portfolio Company B CIP, with Mayhew receiving approximately \$13.8 million of this amount. Fenway Partners did not offset the payments to the Fenway CIP Participants against Fenway Partners' advisory fee from Fund III.

44. Fenway Partners, Lamm, Smart and Mayhew did not disclose to the Fund III Advisory Board or Limited Partners the conflict of interest presented by the proposed CIP payments to the Fenway CIP Participants and the effect on Fund III's return on its investment, as was required by the Organizational Documents and in breach of their fiduciary obligations to their client, Fund III.

45. The inherent conflict of interest associated with the payments to the Fenway CIP Participants was not disclosed in or otherwise authorized by the Organizational Documents. Fenway Partners could not effectively consent to these payments on behalf of Fund III because it was conflicted as the recipients of the CIP payments were affiliates of Fenway Partners.

**iii. Material Omissions to Limited Partners Concerning the CIP Payments**

46. On June 28, 2012, Fenway Partners sent a letter ("Letter") to the Limited Partners informing them of Fund III's and their respective proceeds from the Portfolio Company B sale. Lamm and Smart, in their capacities as the sole members of Fenway Partners' Operating Committee, approved the Letter. Wiacek signed the Letter on behalf of Fenway Partners.

47. The Letter did not disclose the payments to the Fenway CIP Participants. Fenway Partners, Lamm, Smart and Wiacek knew of the CIP payments to the Fenway CIP Participants and that such payments had not been disclosed to the Limited Partners.

48. At the November 7, 2012 meeting of the Fund III Advisory Board, Lamm discussed the sale of Portfolio Company B and noted that it had been one of Fenway Partners' notable achievements in 2012. Lamm praised the work that Mayhew and one other Fenway CIP Participant had done for Portfolio Company B.

49. Lamm and Smart did not, however, disclose that the Fenway CIP Participants had received \$15 million from the Portfolio Company B CIP; that these payments had reduced the fund's return; and that Fenway Partners had not offset such payments against its advisory fee from Fund III.

50. Fenway Partners and Wiacek failed to consider the CIP payments to the Fenway CIP Participants as related party transactions and therefore did not include them in the related party transaction disclosures in the 2012 Fund III financial statements that Fenway Partners provided to the Limited Partners. The CIP payments to the Fenway CIP Participants should have been disclosed in Fund III's financial statements as related party transactions because the payments were made to Mayhew and the other Fenway CIP Participants for services performed while they were employed by Fenway Partners and granted to them while they were employees of an affiliate, Fenway Consulting. When the Auditor subsequently learned of the CIP payments to the Fenway CIP Participants, it withdrew its opinion for the 2012 audited financial statements for Fund III. Fenway Partners subsequently restated the 2012 audited financial statements for Fund III, and included the CIP payments to the Fenway CIP Participants in the related party transaction disclosures.

### VIOLATIONS

51. As a result of the conduct described above, Fenway Partners, Lamm, Smart and Mayhew willfully<sup>2</sup> violated, and Wiacek caused the violations of, Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." A violation of Section 206(2) may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1999) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.*

52. As a result of the conduct described above, Fenway Partners, Lamm and Smart willfully violated, and Wiacek caused the violations of, Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which prohibits any fraudulent, deceptive or manipulative act, practice, or course of business by an investment adviser to an investor or prospective investor in a pooled investment vehicle. A violation of Section 206(4) and the rules thereunder does not require scienter. *Steadman*, 967 F.2d at 647.

### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Sections 203(e), 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

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<sup>2</sup> A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

A. Respondent Fenway Partners cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act, and Rule 206(4)-8 promulgated thereunder.

B. Respondent Fenway Partners is censured.

C. Respondent Lamm cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act, and Rule 206(4)-8 promulgated thereunder.

D. Respondent Lamm is censured.

E. Respondent Smart cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act, and Rule 206(4)-8 promulgated thereunder.

F. Respondent Smart is censured.

G. Respondent Mayhew cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act.

H. Respondent Mayhew is censured.

I. Respondent Wiacek cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act, and Rule 206(4)-8 promulgated thereunder.

J. Respondents Fenway Partners, Lamm, Smart and Mayhew shall pay disgorgement and prejudgment interest, on a joint and several basis, and civil money penalties as follows:

- (1) Respondents Fenway Partners, Lamm, Smart and Mayhew shall pay a total of \$8,716,471.10, consisting of \$7,892,000 of disgorgement, and \$824,471.10 of prejudgment interest pursuant to the provisions of this Subsection J.
- (2) Respondents shall pay a total of \$1,525,000 of civil money penalties pursuant to the provisions of this Subsection J. Payment shall be made as follows:
  - a. \$1,000,000 by Respondent Fenway Partners;
  - b. \$150,000 by Respondent Lamm;
  - c. \$150,000 by Respondent Smart;

- d. \$150,000 by Respondent Mayhew; and
  - e. \$75,000 by Respondent Wiacek.
- (3) Within ten (10) days of entry of this Order, Respondents Fenway Partners, Lamm, Smart, Mayhew and Wiacek shall deposit the full amount of the disgorgement, prejudgment interest and civil money penalties, as described in Paragraphs 1 and 2 of this Subsection J (collectively, the "Distribution Fund") into an escrow account acceptable to the Commission staff and shall provide the Commission staff with evidence of such deposit in a form acceptable to the Commission staff. If timely deposit of the disgorgement and prejudgment interest is not made by the required payment date, additional interest shall accrue pursuant to SEC Rule of Practice 600. If timely deposit of the civil penalties is not made by the required payment date, additional interest shall accrue pursuant to 31 U.S.C. 3717;
- (4) Respondents Fenway Partners, Lamm and Smart (collectively, the "Distribution Respondents") shall be responsible for administering the Distribution Fund. The Distribution Fund represents a reasonable approximation of the harm to the Limited Partners as a result of (a) the payments that Fenway Consulting received from the Portfolio Companies (including, without limitation, Portfolio Company A); and (b) the payments to the Fenway CIP Participants received as a result of the sale of Portfolio Company B. The Distribution Respondents shall distribute the Distribution Fund to the Limited Partners based on each Limited Partner's pro rata interest in Fund III during the Relevant Period pursuant to a disbursement calculation (the "Calculation") that has been submitted to, reviewed, and approved by the Commission staff in accordance with this Subsection J. Within thirty (30) days of the entry of this Order, the Distribution Respondents shall submit a proposed Calculation to the staff for review and approval. The proposed Calculation will include the names of the Limited Partners and payment amounts. The Distribution Respondents also shall provide to the Commission staff such additional information and supporting documentation as the Commission staff may request for its review. In the event of one or more objections by the Commission staff to the proposed Calculation or any of its information or supporting documentation, the Distribution Respondents shall submit a revised Calculation for the review and approval of the Commission staff or additional information or supporting documentation within ten (10) days of the date that the Distribution Respondents are notified of the objection, which revised calculation shall be subject to all of the provisions of Subsection J;

- (5) The distribution of the Distribution Fund shall be made in the next fiscal quarter immediately following the entry of this Order but no later than within ninety (90) days of the date of the Order, unless such time period is extended as provided in Paragraph 10 of this Subsection J. No portion of the Distribution Fund shall be paid to any affected Limited Partner directly or indirectly in the name of or for the benefit of any Respondent in this proceeding;
- (6) If the Distribution Respondents do not distribute any portion of the Disgorgement Fund for any reason, including factors beyond their control, the Distribution Respondents shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury in accordance with Section 21F(g)(3) of the Securities Exchange Act of 1934 after the final accounting provided for in Paragraph 8 of this Subsection J is submitted to the Commission staff. Any such payment shall be made in one of the following ways: (1) electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or (3) by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Marshall Sprung, Co-Chief Asset Management Unit, Division of Enforcement, Los Angeles Regional Office, Securities and Exchange Commission, 444 South Flower Street, Suite 900, Los Angeles, CA 90071;

- (7) The Distribution Respondents agree to be responsible for all tax compliance responsibilities associated with distribution of the Distribution Fund and may retain any professional services necessary. The costs and expenses of any such professional services shall not be paid out of the Distribution Fund;
- (8) Within 180 days after the date of the entry of the Order, the Distribution Respondents shall submit to the Commission staff a final accounting and certification of the disposition of the Distribution Fund not unacceptable to

the staff, which shall be in a format to be provided by the Commission staff. The final accounting and certification shall include: (i) the amount paid or credited to each Limited Partner; (ii) the date of each payment or credit; (iii) the check number or other identifier of money transferred or credited to the Limited Partner; and (iv) any amounts not distributed to be forwarded to the Commission for transfer to the United States Treasury. The Distribution Respondents shall submit the final accounting and certification, together with proof and supporting documentation of such payments and credits in a form acceptable to Commission staff, under a cover letter that identifies Respondents in these proceedings and the file number of these proceedings, to Panayiota K. Bougiamas, Assistant Regional Director, Asset Management Unit, New York Regional Office, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, New York, 10281, or such other address the Commission staff may provide. Any and all supporting documentation for the accounting and certification shall be provided to the Commission staff upon request;

- (9) After the Distribution Respondents have submitted the final accounting to the Commission staff, the staff shall submit the final accounting to the Commission for approval and shall request Commission approval to send any remaining amount to the United States Treasury; and
- (10) The Commission staff may extend any of the procedural dates set forth in this Subsection J for good cause shown. Deadlines for dates related to the Distribution Fund shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall considered to be the last day.

**K.** Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for disgorgement, prejudgment interest and civil money penalties referenced in Paragraph Nos. 1 and 2 of Subsection J. Regardless whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission staff and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this Paragraph, a "Related Investor Action" means a private damages action brought against one or more Respondents by or on behalf of investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondents, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondents under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondents of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
**Assistant Secretary**

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 76338 / November 4, 2015

WHISTLEBLOWER AWARD PROCEEDING

File No. 2016-1

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In the Matter of the Claim for Award

in connection with

Redacted

Notice of Covered Action Redacted

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On July 13, 2015, the Claims Review Staff issued a Preliminary Determination for Notice of Covered Action Redacted. The Preliminary Determination recommended that Redacted (“Claimant”) receive a whistleblower award of Redacted of the monetary sanctions collected in the Covered Action, pursuant to Section 21F(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. § 78u-6(b)(1), and Rule 21F-3(a) thereunder, 17 C.F.R. § 240.21F-3(a).

Based on a consideration of the factors specified in Rule 21F-6, the Claims Review Staff considered the significance of the information provided by the Claimant, the assistance that the Claimant provided, and the law-enforcement interests at issue. The Claims Review Staff also considered the Claimant’s delay in reporting the violations, which, under the circumstances, was found to be unreasonable. Although the Claimant’s delay was limited in duration, it occurred entirely after the creation of the Commission’s whistleblower program under the Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>1</sup> Furthermore, during the period of delay, the violations continued and the respondents in the underlying action obtained additional ill-gotten gains, with a resulting increase in the monetary sanctions upon which the Claimant’s award is based.

On September 10, 2015, Claimant, through counsel, requested an increase in award percentage, arguing that the Claims Review Staff had weighed too heavily the Claimant’s reporting delay in assessing the award percentage. The reconsideration request argued that the personal and professional risks faced by whistleblowers in reporting to the Commission had not

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<sup>1</sup> See Pub. L. No. 111-203, § 922, 124 Stat 1841 (2010).

been adequately considered, that early and prompt reporting may lead to poor quality tips, and that the Claims Review Staff had improperly assessed Claimant's failure to report the misconduct internally in determining the award percentage.

We are not persuaded by Claimant's arguments and the recommendation by the Claims Review Staff that the Claimant receive an award of Redacted is hereby adopted. Given the monetary sanctions collected, the award should yield a payment of over \$325,000.

Contrary to the Claimant's contentions, we have given due consideration to the personal and professional risks faced by whistleblowers in reporting their information to the Commission, and find it significant that the delay here occurred entirely after implementation of the whistleblower program under the Dodd-Frank Act. In considering two prior whistleblower award claims where the period of delay straddled the Dodd-Frank Act, we determined, in our discretion, to give less weight to the unreasonable reporting delay than we "otherwise might have done had the delay occurred entirely after the [whistleblower] program's creation."<sup>2</sup>

This distinction reflects our understanding that the Dodd-Frank Act changed the landscape for whistleblowers. Before the enactment of Section 21F, individuals faced strong disincentives to report violations while still employed at the entity where misconduct was occurring. Congress's establishment of the whistleblower program in the Dodd-Frank Act, however, provided new whistleblower incentives and protections to overcome those powerful disincentives to reporting. Thus, we considered this award, involving a post-Section 21F reporting delay, against the backdrop of Congress's principal purpose "to motivate those with insider knowledge [of securities violations] to come forward" and "take the enormous risk of blowing the whistle in calling attention to fraud."<sup>3</sup>

We also have emphasized that the whistleblower rules "should incentivize the prompt and early submission of high-quality, credible tips."<sup>4</sup> Section 21F provided whistleblowers with confidentiality protections, including the right of whistleblowers to report to the Commission anonymously and to remain anonymous until the time that an award is to be paid.<sup>5</sup> Indeed, Claimant took advantage of these provisions and submitted the Form TCR to the Commission anonymously through counsel. As such, although the duration of the delay was relatively limited, we believe that the delay was unreasonable in light of the incentives and protections now afforded to whistleblowers under the Commission's whistleblower program. Where the period

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<sup>2</sup> See *Order Determining Whistleblower Award Claim*, Exchange Act Release No. 75477, at 2 n.3 (July 17, 2015); *Order Determining Whistleblower Award Claim*, Exchange Act Release No. 73174, at 3 n.5 (Sept. 22, 2014).

<sup>3</sup> S. Rep. 111-176 at 110-11 (Apr. 30, 2010).

<sup>4</sup> *Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934*, Release No. 34-64545, at 217 (Aug. 12, 2011).

<sup>5</sup> Exchange Act Section 21F(d)(2), 15 U.S.C. § 78u-6(d)(2); Rule 21F-7, 17 C.F.R. § 240.21F-7.

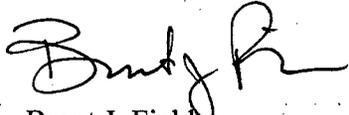
of delay occurs entirely after the creation of the Commission's whistleblower program, we will weigh the delay more heavily in assessing the appropriate award percentage.

We are not persuaded by Claimant's general policy contention that, by encouraging prompt reporting, we may be encouraging the submission of lower-quality tips and complaints. First, this particular case is not one where a whistleblower either took, or reasonably needed to take, additional time to gather more information in order to understand that violations had occurred or to appreciate the scope of the misconduct. More generally we note that whistleblowers are free to, and often do, supplement their initial tips with additional information or materials after making their first submission to the Commission. Additionally, we believe it would undermine our objective of leveraging whistleblower tips to help detect fraud early and thereby prevent investor harm if whistleblowers could unreasonably delay reporting and receive greater awards due to the continued accrual of wrongful profits.<sup>6</sup>

Finally, in determining the award percentage, we did not give negative weight to the fact that Claimant declined to report the violations internally. In assessing the reasonableness of Claimant's delay, we considered the fact that Claimant failed promptly to report the wrongdoing to the Commission, to any other regulator, or through internal reporting mechanisms, and instead waited until after leaving <sup>Redacted</sup> employer to contact the Commission. We did not decrease Claimant's award percentage because <sup>Redacted</sup> declined to report internally, but because after becoming aware of the wrongdoing, <sup>Redacted</sup> did nothing to report the information and did nothing to try to stop the violations from continuing to occur, which under the facts and circumstances, we find unreasonable.<sup>7</sup>

Accordingly, upon due consideration under Rules 21F-10(g) and (h), 17 C.F.R. §§ 240.21F-10(g) and (h), it is hereby ORDERED that the Claimant shall receive an award of <sup>Redacted</sup> of the monetary sanctions collected and to be collected in the Covered Action.

By the Commission.

  
Brent J. Fields  
Secretary

<sup>6</sup> Here, the great majority of the total disgorgement ordered in the underlying enforcement matter was attributable to the misconduct that occurred after Claimant learned about the <sup>Redacted</sup> and before Claimant retained counsel or reported to the Commission, with a resulting increase in the monetary sanctions upon which Claimant's award is based.

<sup>7</sup> We also considered factors that mitigated the unreasonableness of the Claimant's reporting delay. In addition to the limited duration of the delay, we considered the fact that Claimant witnessed a single violation and was unaware of the full extent of the fraud.

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 9976 / November 4, 2015**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 76350 / November 4, 2015**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4256 / November 4, 2015**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 31892 / November 4, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16941**

**In the Matter of**

**Scott A. Doak,**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Scott A. Doak ("Doak" or "Respondent").

## II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

## III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

### Summary

1. These proceedings arise out of a fraudulent scheme conducted by William M. Apostelos ("Apostelos") and companies he controlled. From at least 2010 through 2014, Apostelos violated the registration and anti-fraud provisions of the federal securities laws by conducting fraudulent, unregistered offers of securities and misappropriating investor funds to pay earlier investors and promoters, finance other businesses he and his wife owned, and pay his personal expenses.

2. Respondent Doak became a client of Apostelos no later than 2007. In early 2013, Doak, Apostelos, and other individuals began operating OVO Wealth Management, LLC ("OVO"), a state-registered investment adviser. After approximately a year of operations, OVO was wound down, and Doak made oral and written misrepresentations and omissions to OVO clients to induce them to transfer their advisory accounts to investments controlled by Apostelos.

3. Doak violated the registration provisions of the federal securities laws by offering and selling securities issued by entities controlled by Apostelos. Doak and OVO also violated the anti-fraud provisions of the federal securities laws by making misrepresentations and omissions while advising OVO clients to invest their advisory accounts in investments controlled by Apostelos. Through the same conduct, Doak aided and abetted and caused the violations of Apostelos and OVO.

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

### Respondent

4. **Scott A. Doak**, age 51, is a resident of Xenia, Ohio. Doak was the Chief Executive Officer, a 40% owner, and an investment adviser representative of OVO, a state-registered investment adviser.

### Other Relevant Individuals and Entities

5. **OVO Wealth Management, LLC**, a Delaware limited liability company with its principal place of business in Springboro, Ohio, was registered as an investment adviser in the states of Ohio, Indiana, and Kentucky from early 2013 until December 31, 2014.

6. **William M. Apostelos**, age 54, is a resident of Springboro, Ohio. He was the Treasurer and 40% owner of OVO and Chief Executive Manager of Midwest Green Resources, LLC ("Midwest Green").

7. **Midwest Green Resources, LLC**, an Ohio limited liability company with its principal place of business in Springboro, Ohio, purports to be in the business of investment and real estate asset management. Midwest Green filed a Form D Notice of Exempt Offering of Securities on March 30, 2010, regarding an offering of \$10 million in equity securities but is not otherwise registered with the Commission.

### Background

8. Doak was an emergency medicine physician when he first met Apostelos in 2005. Doak became a client of Apostelos in approximately 2007 and first invested in Midwest Green in November 2012.

9. Also in November 2012, Doak resigned his position as an emergency medicine physician. With Apostelos and other individuals, he formed OVO, a state-registered investment adviser that began operations in early 2013.

10. OVO's business model involved holding client funds in custodial accounts through a registered broker-dealer and investing those funds in publicly traded investments through model portfolios. OVO charged its clients an asset management fee based on assets under management.

11. Doak recruited friends, family members, and others as OVO advisory clients. Doak served as the primary point of contact for OVO's clients, and he also acted as OVO's primary trader.

12. In February 2014, Doak began seeking new employment as a physician. In May 2014, Doak decided to wind down OVO's operations, and he began to contact OVO's clients to discuss closing their accounts.

13. Between May and October of 2014, Doak received payments of at least \$86,833.34 from a non-OVO bank account controlled by Apostelos.

### Misrepresentations and Omissions to OVO Clients

14. Between May and August 2014 (the "relevant period"), Doak advised OVO clients to transfer the funds in their advisory accounts from OVO to Midwest Green and other investments controlled by Apostelos. In total, 17 OVO clients' funds were transferred to a custodian of self-directed IRAs and then to Midwest Green or other accounts controlled by Apostelos.

15. During the relevant period, Doak directly or indirectly offered and sold securities in Midwest Green and other investments controlled by Apostelos. These offerings of securities were unregistered, and no exemption from registration was available.

16. During the relevant period, Doak made material misrepresentations and omissions in connection with his advice to OVO advisory clients and his offer and sale of securities in Midwest Green and other investments controlled by Apostelos.

17. Doak advised at least one advisory client (Client A) to invest in a promissory note investment controlled by Apostelos in order to protect the client's principal from risks in the stock market. Doak assured Client A that the investment was legitimate and would be safer than the stock market, but Doak omitted to state that he had done nothing to verify the existence of this investment or confirm Apostelos's representations about the investment. As a result of these misrepresentations and omissions, Client A transferred the funds in her OVO account to investments controlled by Apostelos.

18. Doak told other advisory clients, including Client B, that Midwest Green invested in real estate and would pay a 10-15% return, and he distributed a copy of a private placement memorandum that contained similar misrepresentations. Doak omitted to state that at the time he was seeking the return of his funds invested in Midwest Green, and that Apostelos had told him his funds could not be returned because the investment was not liquid. Doak also omitted to state that he had done nothing to investigate Midwest Green's business activities, use of investment funds, or investment returns. As a result of these misrepresentations and omissions, Client B transferred the funds in his OVO account to Midwest Green.

19. At the time he advised OVO clients to transfer the funds in their advisory accounts to investments controlled by Apostelos, Doak was aware but omitted to state that at the time he and other investors were trying unsuccessfully to withdraw their funds from Midwest Green and other investments controlled by Apostelos, that he was not being paid on schedule, that Apostelos was bouncing checks, and that certain investors were threatening to sue Apostelos.

### Violations

20. As a result of the conduct described above, Doak willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

21. As a result of the conduct described above, Doak willfully violated Sections 5(a) and 5(c) of the Securities Act, which prohibit, absent an exemption, the offer or sale of securities as to which a registration statement is not filed or in effect.

22. As a result of the conduct described above, Doak willfully aided and abetted and caused Apostelos's violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

23. As a result of the conduct described above, Doak willfully aided and abetted and caused OVO's violations of Sections 17(a)(1) and 17(a)(3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

24. As a result of the conduct described above, Doak willfully aided and abetted and caused OVO's violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Doak's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

- A. Respondent Doak cease and desist from committing or causing any violations and any future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act.
- B. Respondent Doak be, and hereby is:
  - (1) barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and
  - (2) prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.
- C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent Doak shall pay disgorgement of \$86,833.34, prejudgment interest of \$2,874.44, and civil penalties of \$160,000.00 to the Securities and Exchange Commission as follows: \$124,853.89 to be paid within 10 days of the entry of this Order, and the remaining \$124,853.89 to be paid within 1 year of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application.

The Commission may distribute civil money penalties collected in this proceeding if, in its discretion, the Commission orders the establishment of a Fair Fund pursuant to 15 U.S.C. § 7246, Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended. The Commission will hold funds paid pursuant to this paragraph in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or, subject to Exchange Act Section 21F(g)(3), transfer them to the general fund of the United States Treasury.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Doak as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Amy Cotter, Assistant Regional Director, Chicago Regional Office, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, Illinois 60604.

E. Regardless of whether the Commission in its discretion orders the creation of a Fair Fund for the penalties ordered in this proceeding, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall,

within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: Jill M. Peterson  
Assistant Secretary

*Chair White  
Not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 4257 / November 5, 2015

ADMINISTRATIVE PROCEEDING  
File No. 3-16943

In the Matter of

LONNY S. BERNATH,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE  
PROCEEDINGS PURSUANT TO SECTION  
203(f) OF THE INVESTMENT ADVISERS  
ACT OF 1940 AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Lonny S. Bernath ("Respondent" or "Bernath").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Respondent, 43 years old, is a resident of Charlotte, North Carolina. From 2003 to 2014, utilizing successive corporate forms collectively referred to hereafter as "Headline Management," Respondent owned and operated an investment adviser firm registered at different times with the states of Massachusetts and North Carolina. Respondent was himself registered as an Investment Adviser Representative in Massachusetts from 2003 to 2006. At all relevant times, Respondent, through Headline Management, made investment decisions for several private investment funds ("Funds") and was responsible for communications to investors and potential investors in the Funds. As of July 2015, Respondent no longer manages Headline Management or the Funds.

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B. ENTRY OF THE INJUNCTION

2. On October 30, 2015, a judgment was entered by consent against Respondent, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, in the civil action entitled *Securities and Exchange Commission v. Lonny S. Bernath*, Civil Action Number 3:15-CV-00485, in the United States District Court for the Western District of North Carolina.

3. The Commission's complaint alleged that Respondent failed to disclose conflicts of interest presented by loans, investments, and other transactions made between several entities he managed through Headline Management and in which he held financial interests. Specifically, between at least 2007 and 2011, Respondent, without disclosing the transactions or conflicts of interest, directed the Funds to: (a) give loans to and make investments in three real estate limited partnerships that Respondent managed and in which he held a financial interest; (b) make investments in an automotive chrome plating facility in which Respondent held a financial interest; and (c) transfer investments and loans between themselves to meet liquidity needs of each fund. Furthermore, between at least 2009 and 2011, Respondent misrepresented the investment activities of the Funds to investors. Finally, the complaint alleged that, from 2008 until 2011, Respondent periodically wrote down the value of the Funds' investments in these affiliated entities, to the detriment of the Funds' investors and without their knowledge.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: Jill M. Peterson  
Assistant Secretary

*Commissioner Prower  
Not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 4258 / November 5, 2015

ADMINISTRATIVE PROCEEDING  
File No. 3-16945

In the Matter of

Cherokee Investment Partners, LLC and  
Cherokee Advisers, LLC,

Respondents.

**ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS PURSUANT TO  
SECTION 203(k) OF THE INVESTMENT  
ADVISERS ACT OF 1940, MAKING  
FINDINGS, AND IMPOSING A CEASE-  
AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Cherokee Investment Partners, LLC ("CIP") and Cherokee Advisers, LLC ("CA") (collectively referred to as "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

### III.

On the basis of this Order and Respondents' Offer, the Commission finds<sup>1</sup> that:

#### SUMMARY

1. This matter arises from the improper allocation by two affiliated private equity fund advisers to client funds of certain consulting, legal, and compliance-related expenses incurred based on their standing as registered and/or relying investment advisers, as well as other related compliance failures. Cherokee Investment Partners, LLC is a private equity fund adviser that has at all relevant times acted as the manager of two private equity real estate funds with investments in environmentally contaminated property: Cherokee Investment Partners II, L.P. ("Fund II") and Cherokee Investment Partners III, L.P. and Cherokee Investment Partners III Parallel Fund, L.P. (collectively, "Fund III"). Cherokee Advisers, LLC is a private equity fund adviser that has at all relevant times acted as the manager of Cherokee Investment Partners IV, L.P. ("Fund IV") (hereafter, Fund II, Fund III, and Fund IV are collectively referred to as "the Funds").

2. Between July 2011 and March 2015, CIP and CA incurred consulting, legal and compliance-related expenses in the course of either preparing for registration as an investment adviser under the Advisers Act, complying with legal obligations arising from registration (including preparing for examination by the staff of the Commission's Office of Compliance Inspections and Examinations ("Commission Exam staff")), or responding to an investigation of Respondents' conduct by the staff of the Commission's Division of Enforcement ("Commission Enforcement staff"). Respondents allocated to the Funds, and caused the Funds to pay for, \$455,698 of these expenses. Although the Funds' limited partnership agreements disclosed that the Funds would be charged for expenses that in the good faith judgment of the general partner arose out of the operation and activities of the Funds, including the legal and consulting expenses of the Funds, there was no disclosure that the Funds would be charged for the advisers' legal and compliance expenses. As a result, CIP and CA breached their fiduciary duties to the Funds in violation of Section 206(2) of the Advisers Act and also violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

3. Respondents failed to adopt written policies or procedures reasonably designed to prevent violations of the Advisers Act arising from the allocation of expenses to the Funds. Additionally, Respondents failed to adequately review, no less frequently than annually, the adequacy of their policies and procedures to prevent violations of the Advisers Act and the rules thereunder, and the effectiveness of their implementation. Accordingly, Respondents also violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

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<sup>1</sup> The findings herein are made pursuant to Respondents' Offer and are not binding on any other person or entity in this or any other proceeding.

## RESPONDENTS AND RELATED ENTITIES

4. **CIP** is a Delaware limited liability company formed in 1993, with its principal place of business in Raleigh, North Carolina. CIP is a private fund adviser that has been registered with the Commission since March 2012 and has at all times acted as the manager of Fund II and Fund III.

5. **CA** is a Delaware limited liability company formed in 2005, with its principal place of business in Raleigh, North Carolina. CA is a private fund adviser and has at all times acted as the manager of Fund IV. CA is not independently registered with the Commission as an investment adviser; rather, it elected to file as a "relying adviser" on CIP's Form ADV. CA has no employees, is owned by the same persons who own CIP, and carries out its management duties by using CIP's personnel and facilities.

6. **Fund II** is a Delaware limited partnership and private equity fund formed in 1998 to purchase and remediate environmentally contaminated properties with approximately \$250 million in capital commitments from twenty-one investors, including institutional investors. Fund II is in wind down status and currently has no actively managed investments.

7. **Fund III** are Delaware limited partnerships and private equity funds formed in 2002 to purchase and remediate environmentally contaminated properties with approximately \$620 million in capital commitments from fourteen investors, including institutional investors. Fund III is in wind down status and has two remaining actively managed investments.

8. **Fund IV** is a Delaware limited partnership and private equity fund formed in 2005 to purchase and remediate environmentally contaminated properties with approximately \$625 million in capital commitments from fifteen investors, including institutional investors. Fund IV has seven actively managed investments.

## FACTS

9. In May 2011, Respondents began preparations for registering with the Commission as an investment adviser under the Advisers Act in accordance with the then-forthcoming requirements of the Dodd-Frank Act. Respondents retained a third party compliance consultant (hereafter, the "Compliance Consultant") and a law firm to provide consulting and legal services concerning its planned registration as an investment adviser.

10. Respondents allocated to the Funds, and caused the Funds to pay for, certain compliance-related expenses, totaling \$171,232, incurred in the course of either preparing for registration as an investment adviser under the Advisers Act or complying with legal obligations arising from registration. This included the fees charged by the Compliance Consultant to Respondents, as well as other consulting, registration-related legal fees, and compliance-related expenses.

11. In 2013, the Commission Exam staff conducted an examination of Respondents to review Respondents' compliance as a newly-registered adviser and relying adviser with certain provisions of the federal securities laws.

12. Respondents incurred certain expenses, including consulting and legal services, in connection with responding to the Commission Exam staff's review. Respondents allocated to the Funds, and caused the Funds to pay for, certain of these expenses totaling \$239,362.

13. In April 2014, Respondents received notice that the Commission Enforcement staff was conducting an investigation of, among other things, Respondents' allocation of expenses to the Funds. Respondents incurred certain expenses, including paying for legal services in connection with responding to the Commission Enforcement staff's investigation. Respondents allocated to the Funds, and caused the Funds to pay for, certain of these expenses, totaling \$45,104.

14. As detailed in paragraphs 9 through 13, above, between July 2011 and March 2015, Respondents allocated to the Funds, and caused the Funds to pay for, a total of \$455,698 in expenses incurred in the course of preparing for registration as an investment adviser under the Advisers Act, complying with legal obligations arising from registration, and responding to the Commission Exam staff and the Commission Enforcement staff. In connection with this allocation, Respondents sought and received the advice of their counsel and other advisers.

15. In March 2015, Respondents ceased allocating to the Funds all such expenses and, in April 2015, reimbursed the Funds for the full amount of the expenses previously misallocated to them.

16. Although the limited partnership agreements disclosed that the Funds would be charged for expenses that in the good faith judgment of the general partners arose out of the operation and activities of the Funds, the limited partnership agreements did not disclose that the Funds would be charged for a portion of the advisers' own legal and compliance expenses.

17. Separately, Respondents failed to adopt written policies or procedures reasonably designed to prevent violations of the Advisers Act arising from the allocation of expenses to the Funds. Respondents also failed to adequately review, no less frequently than annually, the adequacy of its policies and procedures to prevent violations of the Advisers Act and the rules thereunder, and the effectiveness of their implementation.

### VIOLATIONS

18. Section 206(2) of the Advisers Act prohibits investment advisers from directly or indirectly engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." A violation of Section 206(2) of the Advisers Act may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of

scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.* As a result of the conduct described above, Respondents violated Section 206(2) of the Advisers Act.

19. Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder make it unlawful for any investment adviser to a pooled investment vehicle to “[m]ake any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle” or “engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.” Proof of scienter is not required to establish a violation of Section 206(4) of the Advisers Act. *SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir 1992). As a result of the conduct described above, Respondents violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

20. Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder require registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules, and to review, no less frequently than annually, the adequacy of policies and procedures and the effectiveness of their implementation. As a result of the conduct described above, Respondents violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

#### **RESPONDENTS’ COOPERATION AND REMEDIAL EFFORTS**

In determining to accept Respondents’ Offer, the Commission considered remedial acts taken by Respondents and cooperation afforded the Commission staff.

#### **IV.**

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents’ Offer.

Accordingly, pursuant to Section 203(k) of the Advisers Act, it is hereby ORDERED that:

- A. Respondents cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder.
- B. Respondents shall pay jointly and severally within ten (10) business days of the entry of this Order, a civil monetary penalty in the amount of \$100,000 to the Securities and Exchange Commission for transfer to the general fund of United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

- (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payment by check or money order must be accompanied by a cover letter identifying CIP and CA as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Stephen E. Donahue, Assistant Regional Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 950 E. Paces Ferry Rd., NE, Suite 900, Atlanta, GA 30326-1382.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: Jill M. Peterson  
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934  
Release No. 76376 / November 5, 2015

Admin. Proc. File No. 3-16264

In the Matter of the Application of

ALFRED P. REEVES, III

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION — REVIEW OF DISCIPLINARY  
PROCEEDINGS

Principal of former member firm of registered securities association converted funds of his former employer in violation of just and equitable principles of trade. *Held*, association's findings of violation and sanction imposed are *sustained*.

APPEARANCES:

*Alfred P. Reeves, III*, pro se.

*Alan Lawhead, Jennifer C. Brooks, and Colleen E. Durbin* for the Financial Industry Regulatory Authority, Inc.

Appeal filed: November 7, 2014  
Last brief received: April 17, 2015

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Alfred P. Reeves, III, directed his former employer's clearing firm to wire funds to a bank account he controlled instead of to his former employer's account. We must determine whether this conduct supports FINRA's finding that Reeves converted funds in violation of FINRA Rule 2010, and, if so, whether the sanction imposed by FINRA as a remedy for that violation is excessive or oppressive. We reject Reeves's contentions that he did not know that the funds belonged to his former employer and that FINRA was biased against him; we find that his conversion of his former employer's funds for his own use violated Rule 2010's requirement that associated persons observe "high standards of commercial honor and just and equitable principles of trade;" and we conclude that the bar imposed by FINRA is neither excessive nor oppressive. Accordingly, we sustain FINRA's action.

## I. Background

Reeves has been in the securities industry for over forty years and has worked for several broker-dealers in various principal capacities. During the events at issue, Reeves served as the Financial and Operations Principal ("FINOP") for HWJ Capital Partners II, LLC. He also owned and operated the consulting firm Access Capital Financial Group.

### A. Reeves was HWJ's FINOP from March 2011 through August 2011.

In March 2011, Reeves entered a month-to-month contract with HWJ to serve as the firm's registered FINOP. Two months later, HWJ retained Legent Clearing to provide clearing services to the firm. As HWJ's FINOP, Reeves filled out the necessary paperwork to commence HWJ's relationship with Legent, listing himself as HWJ's "Authorized Billing Contact" and providing his personal cell phone number and email address on the account information form. HWJ's owner signed the agreement and submitted it to Legent.

Reeves continued to work for HWJ until August 30, 2011, when HWJ declined to renew Reeves's contract. The next month, Reeves sent HWJ an invoice in the amount of \$2,000 for services rendered during August. The email transmitting the invoice stated that HWJ's non-renewal of the contract left Reeves in a "financial bind" and that "bookkeeping . . . and any other services for August or in the future are no longer free. Hence, the attached bill. . . . Thank you in advance for sending a check as soon as possible."<sup>1</sup>

### B. HWJ's clearing firm asked Reeves for payment instructions after he had been terminated.

In an October 7 email Legent, HWJ's clearing firm, asked Reeves for payment instructions, writing:

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<sup>1</sup> After brief associations with two other FINRA member firms, Reeves has not been associated with a FINRA member firm since December 2011.

Your September billing invoice is complete and Legent owes you money. We do not have payment instructions on file for you. Please fill out the following Accounting Questionnaire and send back to Correspondent [Billing@legentclearing.com](mailto:Billing@legentclearing.com) We will then be able to get your payment to you.

The Questionnaire asked for information pertaining to broker-dealer clearing services such as (1)"Do you trade in Inventory Accounts?"; (2)"Do you plan to hold inventory positions overnight?"; (3)"What is your Firm's Fiscal Year End?"; and (4)"Do you need limited access to the Billing Folder on your FTP Site?"

Legent asked Reeves for instructions regarding the payment because Legent had not been notified that Reeves was no longer HWJ's FINOP or authorized billing contact. Reeves did not ask Legent or HWJ about the nature of the payment, inform HWJ that Legent owed money on the September invoice, or disclose to Legent that he was no longer HWJ's FINOP. Instead, Reeves filled out the Questionnaire and supplied his own consulting firm's bank account information (Access Capital) and his personal email address and cell phone number. Once Legent received the completed Accounting Questionnaire, it wired \$59,704.93 to the bank account of Access Capital on October 12, 2011.

This payment was owed to HWJ, not Reeves. The \$59,704.93 was a refund of commissions that apparently had been withheld in error on several trades executed by HWJ in the IRA account of the firm's owner.

**C. Reeves disposed of most of the \$59,000 on personal matters.**

Reeves learned that over \$59,000 had been wired into the account of Access Capital when he checked the account balance on approximately October 21, 2011. Before the wire transfer, the balance in the account had been \$156.29. Beginning on October 21, and over the next ten days, Reeves began to use the new funds in the Access Capital account. He wrote a check for \$50,000 that was deposited in an account controlled by his ex-wife, and used \$8,572.05 of the remaining amount for personal expenses, including mortgage and credit card payments. Reeves did not contact either Legent or HWJ concerning the money.

HWJ learned in November 2011 during a routine FINRA examination that Legent had mistakenly withheld the commission money and then unwittingly forwarded the funds to Reeves. In an email to Reeves, HWJ's owner accused him of stealing the money and demanded its return. Reeves denied any wrongdoing, said he did not have access to HWJ's funds, and refused to return the money. The next day, HWJ's owner registered a complaint against Reeves with the FINRA examiner on HWJ's premises; this ultimately led to the investigation that culminated in the instant disciplinary action against Reeves.

Both HWJ and Legent demanded that Reeves repay the \$59,704.93. Reeves offered to resolve the situation by repaying the total at a rate of \$5,000 a month, but stipulated two conditions: that Legent admit that it had "misappropriated" HWJ's funds and paid them to Reeves in error, and that Reeves would pay no money until he had resolved all issues with

FINRA. Legent refused to admit that it had misappropriated the funds, so no agreement was reached among Legent, HWJ and Reeves. Reeves ultimately repaid \$31,000 to HWJ.<sup>2</sup>

**D. FINRA barred Reeves from associating with any FINRA member.**

Based on the complaint from HWJ's owner, FINRA opened an investigation and then filed a disciplinary action against Reeves for conversion of HWJ's funds. A Hearing Panel found that Reeves converted HWJ's funds, barred Reeves for his misconduct, and ordered him to pay restitution of \$28,704.93 plus prejudgment interest. Reeves appealed the decision to the National Adjudicatory Council (the "NAC"). On October 8, 2014, the NAC affirmed the Hearing Panel's decision, finding that Reeves had acknowledged that he directed Legent to pay Access Capital funds "without any plausible reason to believe he was entitled to receive them," that it was "uncontroverted that Reeves spent the funds without HWJ's knowledge or authorization," and that he "has not yet repaid the firm in full . . . ." The NAC affirmed the sanctions imposed by the Hearing Panel. This appeal followed.

**II. Analysis**

**A. Standard of Review**

We base our findings on an independent review of the record and apply a preponderance of the evidence standard for self-regulatory organization disciplinary actions.<sup>3</sup> Pursuant to Exchange Act Section 19(e)(1), in reviewing an SRO disciplinary action, we determine whether the aggrieved person engaged in the conduct found by the SRO, whether such conduct violated the provisions found, and whether those rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.<sup>4</sup>

**B. Reeves intentionally converted HWJ's funds.**

FINRA defines conversion generally as "an intentional and unauthorized taking of and/or exercise of ownership over property by one who neither owns the property nor is entitled to

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<sup>2</sup> FINRA made this assertion in its brief before us and Reeves did not contradict it in his reply brief.

<sup>3</sup> See *Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202, at \*9 (May 27, 2011) (citing *Seaton v. SEC*, 670 F.2d 309, 311 (D.C. Cir. 1982) (upholding preponderance of evidence standard in FINRA disciplinary proceeding)), *aff'd*, 693 F.3d 251 (1st Cir. 2012).

<sup>4</sup> 15 U.S.C. § 78s(e); see, e.g., *Joseph Abbondante*, Exchange Act Release No. 53066, 2006 WL 42393, at \*6 (Jan. 6, 2006), *petition denied*, 209 F. App'x 6 (2d Cir. 2006). Reeves does not argue, and the record does not support a finding, that Rule 2010 is, or FINRA's application of it was, inconsistent with the Exchange Act.

possess it."<sup>5</sup> Although Reeves does not dispute that he directed Legent to wire funds to the account of his own consulting firm, he contends that his actions did not result in conversion because he did not take the money intentionally. Instead, he claims that he provided his consulting firm's account number to Legent because he thought Legent's email was in reference to the invoice for \$2,000 that he had sent HWJ for services rendered in August 2011. Reeves asserts that he did not question the \$59,704.93 increase in his consulting firm's account after Legent wired the money because he was accustomed to receiving large deposits for deals that closed through a broker-dealer that he owned.

The NAC found, and we agree, that the record evidence does not support these claims. Reeves's claim that he thought Legent's email concerned his \$2,000 invoice to HWJ is not plausible. Reeves's termination from HWJ was acrimonious – even Reeves testified that he did not expect HWJ to pay the \$2,000 invoice. And Legent's September email to Reeves stated that *Legent*, not HWJ, owed money. Further, Reeves's invoice for the August services thanked HWJ "in advance for sending a check as soon as possible" (which was consistent with HWJ's past payments to Reeves), but Legent's email asked for account instructions for a wire transfer. Finally, the Account Questionnaire that Legent attached to its email asked for information that a securities professional as experienced as Reeves would have recognized as being related to the provision of clearing services rather than any FINOP or other services Reeves might have provided to HWJ. For example, the form asked about trading in inventory accounts, and whether inventory positions were held overnight. Such information was irrelevant to the payment for Reeves's consulting services to HWJ.

Reeves's claim that he thought that the \$59,704.93 increase in his consulting firm's account could have been related to a deal that closed through his broker-dealer is also unsupported. Although three witnesses testified that they had done large deals with Reeves in the past, they also testified that they did not have any deals with Reeves that were nearly ready to close in the time period at issue. Reeves himself did not point to any deal near completion during this time.

Reeves also argues that it was HWJ's responsibility to notify Legent promptly of Reeves's termination from HWJ's employ. But even if HWJ failed to notify HWJ, that does not negate Reeves's actions in converting the funds. Reeves made no effort to contact Legent or HWJ to clarify the purpose of the payment. In any event, Reeves admits that since at least November 2011, he knew the money was not his and he has not repaid the full balance. As a result, Reeves continued to intentionally exercise unauthorized ownership over HWJ's funds from November 2011 to date.

For all of these reasons, we find that Reeves converted funds both when he directed Legent to wire funds to the Access Capital account and when he continued to hold the funds after HWJ contacted him to demand their return.

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<sup>5</sup> *FINRA Sanction Guidelines* 36.

**C. Reeves violated Rule 2010 when he converted HWJ's funds.**

Reeves's conversion of HWJ's funds violated FINRA Rule 2010. Rule 2010 requires the observance of "high standards of commercial honor and just and equitable principles of trade"<sup>6</sup> and is "designed to enable [FINRA] to regulate the ethical standards of its members."<sup>7</sup> The Rule "serves as an industry backstop for the representation, inherent in the relationship between a securities professional and a customer, that the customer will be dealt with fairly and in accordance with the standards of the profession."<sup>8</sup> To this end, Rule 2010 sets forth a standard intended to encompass "a wide variety of conduct that may operate as an injustice to investors or other participants in the marketplace."<sup>9</sup> It is well settled that conversion violates Rule 2010 because it is "extremely serious and patently antithetical to the 'high standards of commercial honor and just and equitable principles of trade' that [FINRA] seeks to promote."<sup>10</sup>

**III. Sanctions**

Pursuant to Exchange Act Section 19(e)(2), we will sustain a FINRA sanction unless we find, "having due regard for the public interest and the protection of investors," that the sanctions are "excessive or oppressive" or impose an "unnecessary or inappropriate burden on competition."<sup>11</sup> As part of this review, we consider any aggravating or mitigating factors presented<sup>12</sup> and whether the sanctions imposed by FINRA are remedial and not punitive.<sup>13</sup>

<sup>6</sup> Rule 2010 applies to Reeves through FINRA Rule 140, providing that persons associated with a member have the same duties and obligations as a member.

<sup>7</sup> *Heath v. SEC*, 586 F.3d 122, 132 (2d Cir. 2009) (discussing NYSE Rule 476, counterpart to NASD Rule 2010), *aff'g Thomas W. Heath*, Exchange Act Release No. 59223, 2009 WL 56755 (Jan. 9, 2009). We interpret and apply all SRO just-and-equitable rules under the same analysis and precedent. *See, e.g., Dante J. DiFrancesco*, Exchange Act Release No. 66113, 2012 WL 32128, at \*5 & n.19 (Jan. 6, 2012) (applying *Heath*, 2009 WL 56755, at \*4).

<sup>8</sup> *DiFrancesco*, 2012 WL 32128, at \*5 & n.21 (citing *Heath*, 2009 WL 56755, at \*4).

<sup>9</sup> *Id.* at \*5 & n.22 (citing *Heath*, 2009 WL 56755, at \*5 & n.13).

<sup>10</sup> *John Edward Mullins*, Exchange Act Release No. 66373, 2012 WL 423413, at \*11 (Feb. 10, 2012) (internal citations omitted).

<sup>11</sup> 15 U.S.C. § 78s(e)(2). Reeves does not claim, nor does the record show, that FINRA's action imposed an unnecessary or inappropriate burden on competition.

<sup>12</sup> *See Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013); *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1064-65 (D.C. Cir. 2007).

<sup>13</sup> *See PAZ*, 494 F.3d at 1065.

Though not bound by FINRA's Sanction Guidelines, we use them as a benchmark for our review under Exchange Act Section 19(e)(2).<sup>14</sup> For conversion, the Sanction Guidelines recommend imposing a bar as the standard sanction, regardless of the amount converted.<sup>15</sup> The NAC also considered the Sanction Guidelines' Principal Considerations, which include a non-exhaustive list of aggravating and mitigating factors.<sup>16</sup> The relevance of these factors depends on the facts and circumstances of each case.<sup>17</sup>

We find that a bar is consistent with the Sanction Guidelines and sustain the sanction imposed by the NAC because it is neither excessive nor oppressive. Conversion is "among the most grave violations committed by" a securities professional.<sup>18</sup> We find that Reeves engaged in behavior contrary to the high standards of commercial honor and just and equitable principles of trade when he converted HWJ's funds. Specifically, Reeves must have known that when Legent contacted him to repay the funds, Legent was contacting Reeves in his capacity as agent for HWJ. As described above, the nature of the questions in the Accounting Questionnaire provided by Legent made this clear because the questions concerned information relevant to broker-dealer clearing services. Although Reeves knew that he no longer had authority to act as HWJ's agent, he filled out the Accounting Questionnaire and directed Legent to send the funds to the Access Capital account. Once he knew the money was in Access Capital's account, he began withdrawing it. He did not contact either Legent or HWJ to clarify that he was not authorized to act as HWJ's agent; nor did he ask about the source or purpose of the transfer. He exhausted virtually the entire amount that Legent had wired to him. Reeves's conduct demonstrates that he intentionally engaged in the unauthorized conversion of funds.

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<sup>14</sup> *Capwest Sec., Inc.*, Exchange Act Release No. 71340, 2014 WL 198188, at \*9 (Jan. 17, 2014) (citation omitted). FINRA adopted the Sanction Guidelines to ensure "greater consistency, uniformity, and fairness in the sanctions that are imposed for violations." *Richard A. Neaton*, Exchange Act Release 65598, 2011 WL 5001956, at \*12 n.38 (Oct. 20, 2011).

<sup>15</sup> FINRA Sanction Guidelines, <http://www.finra.org/web/groups/industry/@enf/@sg/documents/p011038.pdf>, at 36 ("Sanction Guidelines").

<sup>16</sup> *Id.* at 6-7.

<sup>17</sup> *Id.* at 6.

<sup>18</sup> *Mullins*, 2012 WL 423413, at \*18. We have upheld a bar as an appropriate remedy for conversion in other disciplinary actions. *See, e.g., Denise M. Olson*, Exchange Act Release No. 75838, 2015 WL 5172954, at \*3 (Sept. 3, 2015) ("[A]bsent mitigating factors, conversion 'poses so substantial a risk to investors and/or the markets as to render the violator unfit for employment in the securities industry.'" (internal citations omitted)); *Janet Gurley Katz*, Exchange Act Release No. 61449, 2010 WL 358737, at \*26 (Feb. 1, 2010) (in NYSE case, "[m]isappropriating client funds and making misstatements are serious misconduct, and we have sustained bars as appropriate sanctions in the past for such conduct.").

We agree with the NAC that there are aggravating factors that further support the imposition of a bar. As the NAC found, Reeves deprived HWJ of the use of its \$59,704.93 while benefitting himself.<sup>19</sup> And as the NAC also found, Reeves has not taken any responsibility for his misconduct. Instead, Reeves has blamed HWJ's owner for failing to notify Legent that Reeves had been terminated, blamed Legent for mistakenly deducting the money as commissions in the first place, and blamed FINRA for inappropriate bias.<sup>20</sup>

But any mistakes made by HWJ and Legent would not excuse Reeves's deliberate conduct in converting funds for his own use, and, as described above, we do not credit Reeves's assertion that he thought the October 7 email from Legent concerned a \$2,000 invoice he had submitted to HWJ following his termination. Further, the record does not support his claim of inappropriate FINRA bias as a result of accusations against him by HWJ's owner. Although HWJ's owner accused Reeves of having obtained the money by hacking into HWJ's or Legent's computer system, FINRA's investigation found no support for this accusation and the NAC rejected it. At the hearing, HWJ's owner manifested animosity towards Reeves, but the Hearing Officer repeatedly admonished the owner as to his tone, while reminding Reeves that Reeves had called the owner as a witness. There is no evidence that the owner's accusation of hacking or his animosity influenced either the Hearing Panel or the NAC.

Reeves also contends that FINRA has a vendetta against him stemming from an alleged altercation between Reeves and a FINRA employee at some unidentified time in the past. We reject this contention as unsubstantiated because Reeves offers no evidence of either this alleged altercation nor a vendetta by FINRA as a result. To the extent Reeves argues that he is a victim of selective prosecution, Reeves "must demonstrate that he was unfairly singled out for prosecution based on improper considerations such as race, religion, or the desire to prevent the exercise of a constitutionally protected right."<sup>21</sup> Reeves has made no such showing.

Reeves argues that his unblemished forty-five year career should be taken into account, but the point Reeves intends to make in raising this issue is unclear. Before the NAC, Reeves argued that his formerly discipline-free career was proof that he would not be so unwise as to try to steal money. The NAC rejected this by saying that, under all the circumstances, a person with Reeves's experience would have inquired as to the amount and purpose of the transfer from Legent before directing the payment to his personal account. We agree with this reasoning.

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<sup>19</sup> Sanction Guidelines at 6 (Principal Consideration No. 11).

<sup>20</sup> *Id.* (Principal Consideration No. 2).

<sup>21</sup> *Scott Epstein*, Exchange Act Release No. 59328, 2009 WL 223611, at \*16 (Jan. 30, 2009) (citations omitted), *aff'd*, 416 F. App'x 142 (3rd Cir. 2010).

And to the extent this is an argument for mitigation, "lack of disciplinary history is not a mitigating factor" under FINRA Guidelines because securities professionals "should not be rewarded for acting in accordance with [their] duties."<sup>22</sup>

We also sustain the restitution order imposed by FINRA. The Sanction Guidelines recommend such an order to restore the status quo ante where an identifiable member has suffered a quantifiable loss due to respondent's misconduct.<sup>23</sup> Ordering Reeves to pay restitution to HWJ for the amount that he has not yet repaid, together with prejudgment interest on that amount, is neither excessive nor oppressive.

For all the above reasons, we find that the sanctions imposed by FINRA were neither excessive nor oppressive.

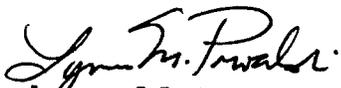
#### IV. CONCLUSION

For all the above reasons, we sustain FINRA's findings that Reeves violated FINRA Rule 2010 and the sanction imposed.

An appropriate order will issue.<sup>24</sup>

By the Commission (Chair WHITE and Commissioners AGUILAR, STEIN, and PIWOWAR).

Brent J. Fields  
Secretary.

  
By: **Lynn M. Powalski**  
**Deputy Secretary**

<sup>22</sup> *Blair Alexander West*, Exchange Act Release No. 74030, 2015 WL 137266, at \*12 (January 9, 2015) (internal citations omitted).

<sup>23</sup> Sanction Guidelines at 4 (General Principle No. 5).

<sup>24</sup> We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934  
Release No. 76376 / November 5, 2015

Admin. Proc. File No. 3-16264

In the Matter of the Application of  
  
ALFRED P. REEVES, III  
  
For Review of Disciplinary Action Taken by  
  
FINRA

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY FINRA

On the basis of the Commission's opinion issued this day, it is  
  
ORDERED that the disciplinary action taken by FINRA against Alfred P. Reeves is  
  
hereby sustained.

By the Commission.

Brent J. Fields  
Secretary

  
By: Lynn M. Powalski  
Deputy Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 76396 / November 9, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16949**

**In the Matter of**  
  
**SANDIP SHAH,**  
  
**Respondent.**

**ORDER INSTITUTING**  
**ADMINISTRATIVE AND CEASE-AND-**  
**DESIST PROCEEDINGS PURSUANT**  
**TO SECTIONS 15(b) AND 21C OF THE**  
**SECURITIES EXCHANGE ACT OF**  
**1934 AND NOTICE OF HEARING**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Sandip Shah ("Respondent" or "Shah").

**II.**

After an investigation, the Division of Enforcement alleges that:

**A.     RESPONDENT**

1.       Respondent, age 41, is a resident of Chino, California. He was in the business of promoting penny stocks and assisting public companies in finding sources of funding. Respondent participated in offerings of the common stock of SOHM, Inc. ("SOHM"), Costas, Inc. ("Costas"), and a third company ("Company A"), each of which is a penny stock. During the relevant period from at least March 10, 2011 through at least May 12, 2011, Respondent was a consultant to Company A. On May 8, 2014, Respondent was indicted on nine counts of wire fraud in *U.S. v. Shah*, 14-CR-10135-NMG (D. Mass.). On May 15, 2015, a jury found him guilty of nine counts of wire fraud. On August 25, 2015, he was ordered to forfeit \$40,000 and, on September 11, 2015, was sentenced to 27 months' imprisonment to be followed by 2 years' supervised release, and was ordered to pay a \$9,000 fine.

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B. OTHER RELEVANT ENTITIES

1. SOHM, Inc. is a Nevada company with its principal place of business currently in Corona, California. SOHM purports to manufacture and distribute generic pharmaceuticals in emerging markets in Asia, Africa, and Latin America. The common stock of SOHM is publicly quoted on OTC Link under the symbol "SHMN."

2. Costas, Inc. is a Nevada company with its principal place of business currently in Tempe, Arizona. Costas purports to provide digital media consulting and other services in India and the United States. Its securities had been registered with the Commission under Exchange Act Section 12(g), but it filed a Form 15-12G on July 17, 2006 terminating its securities registration. The common stock of Costas is publicly quoted on OTC Link under the symbol "CSSI."

3. Shailesh Shah, age 49, a resident of Chino, California, was the President and Chief Executive Officer ("CEO") of SOHM, a publicly traded company that purported to manufacture and distribute generic pharmaceuticals in emerging markets in Asia, Africa, and Latin America. Shailesh Shah was also the President and CEO of Costas, a publicly traded company that purported to provide digital media consulting and other services. Shailesh Shah was charged by criminal information with two counts each of mail fraud and wire fraud on May 8, 2014 and pleaded guilty to all counts on July 18, 2014 in *U.S. v. Shah*, 14-CR-10136-RGS (D. Mass.). On June 23, 2015, Shailesh Shah was sentenced to 18 months' probation and, on June 25, 2015, was ordered to forfeit \$37,500.

C. KICKBACK SCHEMES

1. The "Company A" Scheme

a. These proceedings arise out of a fraudulent scheme in which insiders of publicly-traded penny stock companies paid secret kickbacks to a purported corrupt hedge fund manager, who was in fact an undercover agent with the Federal Bureau of Investigation ("Fund Manager"), in exchange for the Fund Manager's purchase of restricted stock of the penny stock companies on behalf of his purported hedge fund ("the Fund"), which did not actually exist.

b. On or about March 10, 2011, an individual who was serving as a cooperating witness for the Federal Bureau of Investigation and was in the business of promoting penny stocks and assisting public companies in finding sources of funding ("CW") introduced RT, the President and CEO of Company A, a company which purported to design military defense technology, and Respondent, a consultant to Company A, to the Fund Manager ("Company A Meeting").

c. At the Company A Meeting, the Fund Manager informed Respondent and RT that he was a manager of an investment fund and was willing to invest

money in companies in return for a fifty percent kickback that would go to the Fund Manager. Respondent and RT were told that the Fund was not to be informed of the kickback payments. The Fund Manager also discussed the mechanics of the funding, informing Respondent and RT that he was willing to invest up to \$5 million of the Fund's money in Company A, but that, in order to avoid detection, he would invest the money over time, in "tranches" of increasing amounts. The Fund Manager further explained that, after Company A received the Fund's money, fifty percent of the money would be kicked back by Company A to a nominee company controlled by the Fund Manager and about which the Fund had no knowledge. Finally, the Fund Manager explained that, in order to conceal the kickback payments, the nominee company would issue a series of invoices to Company A for services that were never rendered. After the Fund Manager had explained the scheme, RT agreed to enter into the kickback arrangement.

d. After the Company A Meeting, and as Respondent was aware, RT prepared the documents related to the scheme, including a consulting agreement with one of the Fund Manager's nominee companies, and sent the documents to the Fund Manager via e-mail. Following the Company A Meeting, as Respondent was aware, the Fund Manager invested a total of \$80,000 of the Fund's money in Company A in three wire transfer installments of \$15,000, \$25,000, and \$40,000. As Respondent was aware, the Fund Manager received a total of \$40,000 in kickbacks from Company A and RT in three wire transfer kickback payments of \$7,500, \$12,500, and \$20,000.

e. Specifically, on or about March 14, 2011, \$15,000 was sent by wire transfer from a bank account maintained in Boston, Massachusetts purportedly belonging to the Fund to a corporate bank account of Company A. The wire transfer represented the first tranche of funding for Company A.

f. On or about March 15, 2011, RT caused \$7,500 to be sent by wire transfer from a corporate bank account of Company A to a bank account in Boston, Massachusetts, purportedly belonging to one of the Fund Manager's nominee companies. This wire transfer represented the kickback to the Fund Manager from the first tranche of funding for Company A.

g. On or about April 4, 2011, \$25,000 was sent by wire transfer from a bank account maintained in Boston, Massachusetts purportedly belonging to the Fund to a corporate bank account of Company A. The wire transfer represented the second tranche of funding for Company A.

h. On or about April 6, 2011, RT caused \$12,500 to be sent by wire transfer from a corporate bank account of Company A to a bank account in Boston, Massachusetts purportedly belonging to one of the Fund Manager's nominee companies. This wire transfer represented the kickback to the Fund Manager from the second tranche of funding for Company A.

i. On or about April 29, 2011, \$40,000 was sent by wire transfer from a bank account maintained in Boston, Massachusetts purportedly belonging

to the Fund to a corporate bank account of Company A. The wire transfer represented the third tranche of funding for Company A.

j. On or about May 4, 2011, RT caused \$20,000 to be sent by wire transfer from a corporate bank account of Company A to a bank account in Boston, Massachusetts purportedly belonging to one of the Fund Manager's nominee companies. This wire transfer represented the kickback to the Fund Manager from the third tranche of funding for Company A.

k. On various dates between on or about March 17, 2011 and on or about May 3, 2011, RT caused stock certificates representing the purchase by the Fund of three tranches of Company A stock – for 25,000, 38,462, and 50,000 Company A shares, respectively – to be sent to the Fund Manager.

## 2. The SOHM, Inc. Scheme

a. Following the Company A Meeting, Respondent found and introduced the Fund Manager to two additional companies in which the Fund Manager could invest the Fund's money in exchange for kickbacks to the Fund Manager. First, on or about April 14, 2011, Respondent, along with CW, introduced Shailesh Shah and his company SOHM to the Fund Manager (the "SOHM Meeting"). Although, prior to the meeting, the Fund Manager had not directly offered Respondent a percentage of the kickback, Respondent knew going into the SOHM Meeting that the Fund Manager planned to meet with him separately, and Respondent expected to be compensated for finding and introducing Shailesh Shah and SOHM to the Fund.

b. At the SOHM Meeting, the Fund Manager once again explained the mechanics of the scheme including that he was a manager of an investment fund who was willing to invest money in companies in return for a fifty percent kickback to the Fund Manager and that the Fund's investors had no knowledge about the nature of the proposed deal. The Fund Manager also discussed the mechanics of the funding, informing Respondent and Shailesh Shah that he would invest \$5 million of the Fund's money in SOHM but that he would invest the money over time, in "tranches" of increasing amounts. The Fund Manager also explained that, after SOHM received the Fund's money, fifty percent of the money would be kicked back by SOHM to a nominee company that was controlled by the Fund Manager and had no relationship with the Fund. The Fund Manager explained that, in order to conceal the kickback payments, the nominee company would issue a series of invoices to SOHM for services that were never rendered. After the Fund Manager described the scheme, Shailesh Shah agreed to enter into the kickback arrangement.

c. As planned, at the conclusion of the meeting, Shailesh Shah and CW left, and Respondent remained to discuss compensation with the Fund Manager. Respondent agreed with the Fund Manager that the Fund Manager would pay Respondent a portion of the kickbacks paid by Company A, SOHM and any other companies that Respondent introduced into the scheme.

d. Following the SOHM Meeting, as Respondent was aware, Shailesh Shah prepared the documents related to the scheme, including a consulting agreement with one of the Fund Manager's nominee companies, and sent the documents to the Fund Manager via e-mail. Thereafter, as Respondent was aware, the Fund Manager invested a total of approximately \$50,000 of the Fund's money in SOHM in two wire transfer installments of approximately \$20,000 and \$30,000 and received a total of \$25,000 in kickbacks from SOHM and Shailesh Shah in two wire transfer kickback payments of \$10,000, and \$15,000.

e. Specifically, on or about April 20, 2011, \$20,000.04 was sent by wire transfer from a bank account maintained in Boston, Massachusetts purportedly belonging to the Fund to a corporate bank account of SOHM. The wire transfer represented the first tranche of funding for SOHM.

f. On or about April 21, 2011, Shailesh Shah caused \$10,000 to be sent by wire transfer from a corporate bank account of SOHM to a bank account in Boston, Massachusetts purportedly belonging to one of the Fund Manager's nominee companies. This wire transfer represented the kickback to the Fund Manager from the first tranche of funding for SOHM.

g. On or about May 6, 2011, \$30,000 was sent by wire transfer from a bank account maintained in Boston, Massachusetts purportedly belonging to the Fund to a corporate bank account of SOHM. The wire transfer represented the second tranche of funding for SOHM.

h. On or about May 9, 2011, Shailesh Shah caused \$15,000 to be sent by wire transfer from a corporate bank account of SOHM to a bank account in Boston, Massachusetts purportedly belonging to one of the Fund Manager's nominee companies. This wire transfer represented the kickback to the Fund Manager from the second tranche of funding for SOHM.

i. On various dates between on or about April 21, 2011 and on or about May 10, 2011, Shailesh Shah caused stock certificates representing the purchase by the Fund of two tranches of SOHM stock – one for 1666,667 SOHM shares and another for 150,000 SOHM shares – to be sent to the Fund Manager.

### 3. The Costas, Inc. Scheme

a. On or about May 3, 2011, Respondent, along with CW, introduced a second company, Costas, to the Fund Manager on a conference call (the "Costas Call"). During the Costas Call, Respondent, Shailesh Shah, CW, and the Fund Manager discussed a potential investment of the Fund's money in Costas, which was also run by Shailesh Shah, in exchange for a fifty percent kickback to the Fund Manager. The Fund Manager again explained that, after Costas received the Fund's investment, fifty percent of the money would be secretly kicked back to the Fund Manager. After the

participants in the conference call discussed the scheme, Shailesh Shah agreed to enter into the kickback arrangement involving Costas.

b. Thereafter, as Respondent was aware, Shailesh Shah prepared the documents related to the scheme, including a consulting agreement with one of the Fund Manager's nominee companies, and sent the documents to the Fund Manager via e-mail. As Respondent was aware, the Fund Manager subsequently invested a total of \$25,000 of the Fund's money in Costas, and received a total of \$12,500 in kickbacks from Costas and Shailesh Shah.

c. Specifically, on or about May 6, 2011, \$25,000 was sent by wire transfer from a bank account maintained in Boston, Massachusetts purportedly belonging to the Fund to a corporate bank account of Costas. The wire transfer represented the first tranche of funding for Costas.

d. On or about May 9, 2011, Shailesh Shah caused \$12,500 to be sent by wire transfer from a corporate bank account of Costas to a bank account in Boston, Massachusetts purportedly belonging to one of the Fund Manager's nominee companies. This wire transfer represented the kickback to the Fund Manager from the first tranche of funding for Costas.

e. On or about May 10, 2011, Shailesh Shah caused stock certificates representing the purchase by the Fund of 35,715 Costas shares to be sent to the Fund Manager.

4. Respondent Receives a Portion of the Kickback Monies

a. Pursuant to the April 11, 2014 agreement between Respondent and the Fund Manager, the Fund Manager sent Respondent a total of \$5,750, which was a portion of the kickbacks paid by the executives of Company A, SOHM, and Costas and represented Respondent's compensation for having introduced the company executives to the Fund Manager and for his facilitation of the on-going schemes.

b. Specifically, on or about April 25, 2011, pursuant to wiring instructions provided by Respondent, a \$1,000 payment was sent by wire transfer from a bank account in Boston, Massachusetts purportedly belonging to one of the Fund Manager's nominee companies to a personal bank account controlled by Respondent. In accordance with the agreement reached between Respondent and the Fund Manager during the SOHM Meeting, the \$1,000 represented Respondent's share of the kickback received by the Fund Manager in connection with the first tranche of Fund money invested in SOHM.

c. Similarly, on or about May 5, 2011, pursuant to wiring instructions provided by Respondent, a \$2,000 payment was sent by wire transfer from a bank account in Boston, Massachusetts purportedly belonging to one of the Fund Manager's nominee companies to a personal bank account controlled by Respondent. In

accordance with the agreement reached between Respondent and the Fund Manager during the SOHM Meeting, the \$2,000 represented Respondent's share of the kickback received by the Fund Manager in connection with the third tranche of Fund money invested in Company A.

d. Finally, on or about May 12, 2011, pursuant to wiring instructions provided by Respondent, a \$2,750 payment was sent by wire transfer from a bank account in Boston, Massachusetts purportedly belonging to one of the Fund Manager's nominee companies to a personal bank account controlled by Respondent. In accordance with the agreement reached between Respondent and the Fund Manager during the SOHM Meeting, the \$2,750 represented Respondent's share of the kickbacks received by the Fund Manager in connection with the second tranche of Fund money invested in SOHM and with the Fund's investment in Costas.

#### D. VIOLATIONS

1. As a result of the conduct described above, Respondent willfully violated Section 10(b) of the Exchange Act and Rule 10b-5(a) thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

### III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement, and civil penalties pursuant to Section 21B of the Exchange Act; and

C. Whether, pursuant to Section 21C of the Exchange Act, Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, whether Respondent should be ordered to pay a civil penalty pursuant to Section 21B(a) of the Exchange Act, and whether Respondent should be ordered to pay disgorgement pursuant to Sections 21B(e) and 21C(e) of the Exchange Act.

### IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an

Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
**Assistant Secretary**

**UNITED STATES OF AMERICA**  
Before the  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
Release No. 76398 / November 9, 2015

**ADMINISTRATIVE PROCEEDING**  
File No. 3-16950

In the Matter of

**SHAILEISH SHAH,**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTIONS 15(b) AND 21C  
OF THE SECURITIES EXCHANGE ACT OF  
1934, MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Shaileish Shah ("Shah" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") that the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

**III.**

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

## Summary

These proceedings arise out of a fraudulent scheme in which insiders of publicly traded penny stock companies paid secret kickbacks to a purported corrupt hedge fund manager, who was in fact an undercover agent with the Federal Bureau of Investigation ("Fund Manager"), in exchange for the Fund Manager's purchase of restricted stock of the penny stock companies on behalf of his purported hedge fund ("the Fund"), which did not actually exist.

## Respondent

1. Respondent, age 49, a resident of Chino, California, was the President and Chief Executive Officer ("CEO") of SOHM, Inc. ("SOHM"), a publicly traded company that manufactures and distributes generic pharmaceuticals in emerging markets in Asia, Africa, and Latin America. Respondent was also the President and CEO of Costas, Inc. ("Costas"), a publicly traded company that provided digital media consulting and other services. Respondent participated in offerings of SOHM and Costas stock, which are penny stocks. Respondent was charged by criminal information with two counts each of mail fraud and wire fraud on May 8, 2014 and pleaded guilty to all counts on July 18, 2014 in *U.S. v. Shah*, 14-CR-10136-RGS (D. Mass.). On June 23, 2015, Respondent was sentenced to 18 months' probation and, on June 25, 2015, was ordered to forfeit \$37,500.

## Other Relevant Entities and Individuals

2. SOHM, Inc. is a Nevada company with its principal place of business currently in Chino Hills, California. SOHM manufactures and distributes generic pharmaceuticals in emerging markets in Asia, Africa, and Latin America. The common stock of SOHM is publicly quoted on the OTC Link under the symbol "SHMN."

3. Costas, Inc. is a Nevada company with its principal place of business currently in Tempe, Arizona. Costas purports to provide digital media consulting and other services in India and the United States. Its securities had been registered with the Commission under Exchange Act Section 12(g), but it filed a Form 15-12G on July 17, 2006 terminating its securities registration. The common stock of Costas is publicly quoted on OTC Link under the symbol "CSSI."

4. Sandip Shah, age 41, is a resident of Chino, California. Sandip Shah was in the business of promoting penny stocks and assisting public companies in finding sources of funding. On May 8, 2014, Sandip Shah was indicted on nine counts of wire fraud in *U.S. v. Sandip Shah*, 14-CR-10135-NMG (D. Mass.). On May 15, 2015, a jury found him guilty of nine counts of wire fraud.

## Background

5. On or about April 14, 2011, Respondent met with the Fund Manager, an individual who was serving as a cooperating witness for the Federal Bureau of Investigation

("CW"), and Sandip Shah (the "April 14 SOHM Meeting") to discuss a potential investment of the Fund's money in SOHM in exchange for a fifty percent kickback to the Fund Manager. At the April 14 SOHM Meeting, the Fund Manager informed Respondent and Sandip Shah that the Fund Manager was a manager of an investment fund who was willing to invest money in companies in return for a fifty percent kickback that would go to the Fund Manager. Respondent and Sandip Shah were told that the Fund was not to be informed of the kickbacks.

6. In particular, the Fund Manager told Respondent and Sandip Shah during the April 14 SOHM meeting that he would invest \$5 million of the Fund's money in SOHM, but that he would invest the money over time, in "tranches" of increasing amounts. The Fund Manager also explained that, after SOHM received the Fund's money, fifty percent of the money would be kicked back by SOHM to a nominee company, which the Fund Manager controlled, and which had no relationship with the Fund. Even though the Fund Manager would provide no consulting services, SOHM would enter into a consulting agreement with the Fund Manager's nominee company to conceal the kickback payments. The Fund Manager explained that, in order to conceal the kickback payments, the nominee company would issue a series of invoices to SOHM for services that were never rendered.

7. After the Fund Manager had discussed the scheme, Respondent agreed to enter into the kickback arrangement. Thereafter, Respondent prepared the documents related to the scheme, including a consulting agreement with one of the Fund Manager's nominee companies, and sent the documents to the Fund Manager via e-mail.

8. On or about May 3, 2011, Respondent participated in a conference call with the Fund Manager, CW, and Sandip Shah to discuss a potential investment of the Fund's money in Costas in exchange for a fifty percent kickback to the Fund Manager (the "May 3 Costas Call"). On the May 3 Costas Call, the Fund Manager again explained that after Costas received the Fund's money, fifty percent of the money would be kicked back to the Fund Manager.

9. After the Fund Manager had discussed the scheme, Respondent agreed to enter into the kickback arrangement involving investments by the Fund in Costas. Thereafter, Respondent prepared the documents related to the scheme, including a consulting agreement with one of the Fund Manager's nominee companies, and sent the documents to the Fund Manager via e-mail.

10. On various dates between on or about April 20, 2011 and on or about May 6, 2011, in accordance with wiring instructions provided by Respondent, three payments of \$20,000.04, \$30,000, and \$25,000 – a total of approximately \$75,000 – were sent by wire transfer from a bank account maintained in Boston, Massachusetts purportedly belonging to the Fund to a corporate bank account of SOHM and a corporate bank account of Costas controlled by Respondent.

11. On various dates between on or about April 21, 2011 and on or about May 9, 2011, Respondent paid kickbacks of \$37,500 to the Fund Manager in three payments of \$10,000, \$15,000, and \$12,500, respectively, which Respondent caused to be sent by wire transfer

from a corporate bank account in the name of SOHM and a corporate bank account in the name of Costas to a bank account in Boston, Massachusetts purportedly belonging to one of the Fund Manager's nominee companies.

12. On various dates between on or about April 21, 2011 and on or about May 10, 2011, Respondent caused stock certificates representing the purchase by the Fund of 166,667 SOHM shares, 150,000 SOHM shares, and 35,715 Costas shares to be sent to the Fund Manager.

13. As a result of the conduct described above, Respondent willfully violated Section 10(b) of the Exchange Act and Rule 10b-5(a) thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Shailesh Shah's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

- A. Respondent Shailesh Shah shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.
- B. Respondent Shailesh Shah be, and hereby is:

prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act [15 U.S.C. § 781] or that is required to file reports pursuant to Section 15(d) of the Exchange Act [15 U.S.C. § 78o(d)] for a period of five (5) years from entry of this Order; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock, with the right to apply for reentry after five (5) years to the appropriate self-regulatory organization, or if there is none, to the Commission. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the

conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 76399 / November 9, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16951**

**In the Matter of**

**HADI ABOUKHATER**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTIONS 15(b) AND 21C  
OF THE SECURITIES EXCHANGE ACT OF  
1934, MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Hadi Aboukhater ("Aboukhater" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") that the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

**III.**

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

## Summary

These proceedings arise out of a fraudulent scheme in which insiders of publicly-traded penny stock companies paid kickbacks to a purported hedge fund manager, who was in fact an undercover agent with the Federal Bureau of Investigation ("Fund Manager"), in exchange for the Fund Manager's purchase of restricted stock of the penny stock companies on behalf of his purported hedge fund ("the Fund"), which did not actually exist.

## Respondent

1. Aboukhater, age 44, a resident of Haymarket, Virginia, was in the business of assisting public companies in finding sources of funding. Many of the publicly traded companies Aboukhater assisted were penny stock companies whose common stock was publicly quoted on OTC Link. During the period January 2011 through May 10, 2011, Aboukhater participated in offerings of at least six penny stocks. On February 27, 2014, Aboukhater was charged by criminal information with one count of wire fraud, and he pleaded guilty to that charge on March 25, 2014 in *U.S. v. Aboukhater*, 14-CR-10057-DJC (D. Mass.). On January 26, 2015, the Court ordered Aboukhater to serve two years' probation, pay a fine of \$10,000 and a special assessment of \$100, and forfeit \$12,425.

## Background

2. On or about December 21, 2010, Aboukhater met the Fund Manager. At the meeting, the Fund Manager offered to pay Aboukhater a fee for introducing to the Fund Manager executives of publicly traded companies who would agree to pay kickbacks to the Fund Manager in exchange for funding for their respective publicly traded companies from the Fund.

3. Aboukhater was told that the Fund Manager was prepared to invest up to \$5 million of the Fund's money in various publicly traded companies, provided that each company kicked back fifty percent of those funds – up to \$2,500,000 – to the Fund Manager. Aboukhater was told that the Fund was not to be informed of the kickbacks.

4. Aboukhater was told that if the Fund purchased \$5 million of stock in a company all at once, the transaction might attract the attention of the Fund's regulatory compliance officials. In order to avoid detection, therefore, the Fund Manager offered to invest the Fund's money gradually, in tranches (or installments) that would increase in size over time. Aboukhater also was told that the kickbacks would be made to one or more consulting companies that the Fund Manager purportedly controlled.

5. Aboukhater was told that the Fund Manager would pay Aboukhater a portion of the kickbacks paid by any executive whom Aboukhater introduced to the scheme. Aboukhater agreed to make the introductions.

6. On various dates between on or about January 13, 2011 and May 10, 2011, Aboukhater introduced four executives from six different publicly traded companies to the Fund

Manager so that each of those executives could enter into the funding/kickback agreement. Aboukhater was present during meetings between each of the executives and the Fund Manager, at which each of the executives agreed to pay kickbacks to the Fund Manager in exchange for funding from the Fund.

7. At these meetings, the executives were told that the Fund Manager was prepared to invest up to \$5 million of the Fund's money in their respective companies provided that the executives kicked back fifty percent of the funds to the Fund Manager and that, in order to avoid detection by the Fund's compliance officials, the investment would be executed in tranches.

8. At these meetings, the executives also were told to make the kickback payments to one of the Fund Manager's consulting companies. The executives were instructed to create manufactured invoices for non-existent "consulting services" purportedly rendered by the consulting companies, in order to create the false appearance that the kickback payments were compensation for consulting services.

9. Based on his agreement with the Fund Manager, on various dates between on or about January 28, 2011 and April 29, 2011, Aboukhater received a total of \$12,425 as his portion of the kickbacks paid by most of the executives he introduced to the Fund Manager. Most of Aboukhater's portions of the kickbacks were paid by wire transfers from one of the consulting companies to Aboukhater's bank account.

10. As a result of the conduct described above, Aboukhater willfully violated Section 10(b) of the Exchange Act and Rule 10b-5(a) thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Aboukhater's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Aboukhater shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Aboukhater be, and hereby is:

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny

stock, with the right to apply for reentry after five (5) years to the appropriate self-regulatory organization, or if there is none, to the Commission. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
**Assistant Secretary**

*Commissioner Pinowar  
Dissented as to the  
penalties*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 76401 / November 9, 2015

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3717 / November 9, 2015

ADMINISTRATIVE PROCEEDING  
File No. 3-16952

In the Matter of

Larry D. Liberfarb, P.C.,

Respondent.

ORDER INSTITUTING PUBLIC  
ADMINISTRATIVE AND CEASE-  
AND-DESIST PROCEEDINGS  
PURSUANT TO SECTIONS 4C AND 21C  
OF THE SECURITIES EXCHANGE ACT  
OF 1934 AND RULE 102(e) OF THE  
COMMISSION'S RULES OF PRACTICE,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A  
CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Larry D. Liberfarb, P.C. ("Liberfarb" or "Respondent") pursuant to Sections 4C<sup>1</sup> and 21C of the Securities

<sup>1</sup> Section 4C provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

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Exchange Act of 1934 (“Exchange Act”) and Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.<sup>2</sup>

## II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this the Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission’s Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

## III.

On the basis of this Order and Respondent’s Offer, the Commission finds<sup>3</sup> that:

### A. SUMMARY

This matter concerns violations of the Commission’s auditor independence rules by Liberfarb. Liberfarb audited the annual financial statements that were filed with the Commission for 20 broker-dealer audit clients for the fiscal years ending January 1, 2010 through September 30, 2011. For at least one audit of each of these broker-dealer audit clients, Liberfarb was not independent under auditor independence criteria established by the Commission and made applicable by Exchange Act Rule 17a-5(f)(3) to audits of brokers and dealers.<sup>4</sup> As a result of this

<sup>2</sup> Rule 102(e)(1)(ii) provides, in relevant part, that:

The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

<sup>3</sup> The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

<sup>4</sup> The provisions of Exchange Act Rule 17a-5 referred to herein are those in effect during, and applicable to, the relevant conduct. On July 30, 2013, the Commission adopted certain amendments to Rule 17a-5. *See* Broker-Dealer Reports, SEC Exchange Act Release No. 34-70073 (July 30, 2013), 78 Fed. Reg. 51910 (Aug. 21, 2013). Among other things, the amendments to Rule 17a-5 require that audits of brokers and dealers be performed in accordance with Public Company Accounting Oversight Board standards, effective for audits of fiscal years ending on or after June 1, 2014. The auditor independence requirement of Rule 2-01 of Regulation S-X applied to broker-dealer audits both before and after the July 30, 2013 amendments. At the

conduct, Liberfarb engaged in improper professional conduct, violated the auditor independence rules, and caused each of the broker-dealers' failure to file an annual report audited by an independent accountant.

## **B. RESPONDENT**

Respondent Liberfarb, a professional corporation, is an accounting and auditing firm registered with the Public Company Accounting Oversight Board ("PCAOB"). Liberfarb has one shareholder, Larry D. Liberfarb, and is located in Norwood, Massachusetts. During the Relevant Period, Liberfarb also employed, on a part-time basis, a Certified Public Accountant who assisted the firm with audit engagements.

## **C. FACTS**

### **1. Lack of Independence**

a. During fiscal years ending January 1, 2010 through September 30, 2011 (the "Relevant Period"), Liberfarb served as the independent public accountant for 20 broker-dealer audit clients. In connection with at least one audit performed for each of these broker-dealer audit clients during the Relevant Period, Liberfarb prepared the financial statements and/or notes to the financial statements that were filed with the Commission on Form X-17A-5.

b. For example, Liberfarb audited the annual financial statements for Broker-Dealer A for the fiscal year ending September 30, 2011. During the audit, Liberfarb was provided with financial documents generated by Broker-Dealer A, including a balance sheet and a profit and loss statement. Liberfarb reviewed and tested these documents, and the financial data contained therein, as part of the audit.

c. Liberfarb then utilized the information contained in these documents to create and revise a set of financial statements to be filed with the Commission. In particular, using the prior year's financial statements as a template, Liberfarb personnel working on Liberfarb computers typed and updated the new set of financial statements, including the notes to the financial statements. Liberfarb then provided the set of financial statements it had prepared to Broker-Dealer A's management for approval.

d. In November 2011, Broker-Dealer A filed with the Commission a Form X-17A-5 Part III for the fiscal year ended September 30, 2011. Included in that filing is an audit report signed by Liberfarb and stating, among other things, that Liberfarb's audit of Broker-Dealer A was conducted "in accordance with auditing standards generally accepted in the United States of America."

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time of the relevant conduct, prior to the amendments, that requirement was set out in Rule 17a-5(f)(3). It is now set out in Rule 17a-5(f)(1).

e. Liberfarb engaged in substantially similar conduct in connection with at least one audit for 19 additional broker-dealer clients during the Relevant Period.

## 2. Violations

a. Section 17(e)(1)(A) of the Exchange Act requires that every registered broker or dealer “annually file with the Commission a balance sheet and income statement certified by an independent public accounting firm, or by a registered public accounting firm if the firm is required to be registered under the Sarbanes-Oxley Act of 2002, prepared on a calendar or fiscal year basis, and such other financial statements (which shall, as the Commission specifies, be certified) and information concerning its financial condition as the Commission, by rule may prescribe as necessary or appropriate in the public interest or for the protection of investors.”

b. Exchange Act Rule 17a-5(e)(1)(i) states: “An audit shall be conducted by a public accountant who shall be in fact independent as defined in paragraph (f)(3) of this section herein, and he shall give an opinion covering the statements filed pursuant to paragraph (d) . . . .” Exchange Act Rule 17a-5(f)(3) further states that, for such audits, “[a]n accountant shall be independent in accordance with the provisions of Rule 2-01(b) and (c) of Regulation S-X.”

c. Exchange Act Rule 17a-5(g) requires that “[t]he audit shall be made in accordance with generally accepted auditing standards” and Exchange Act Rule 17a-5(i) requires that “[t]he accountant’s report shall . . . [s]tate whether the audit was made in accordance with generally accepted auditing standards.” Generally accepted auditing standards (“GAAS”) require auditors to maintain strict independence from their audit clients; an auditor “must be free from any obligation to or interest in the client, its management or its owners.” *See* Statement on Auditing Standard No. 1, Section 220.03. Accordingly, if an auditor’s report states that its audit was performed in accordance with GAAS when the auditor was not independent, then it has violated Exchange Act Rule 17a-5(i). *See In the Matter of Rosenberg Rich Baker Berman & Company and Brian Zucker, CPA*, Exchange Act Release No. 69765 at p. 5 (June 14, 2013).

d. Rule 2-01(c)(4) of Regulation S-X provides that an accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides prohibited non-audit services to an audit client. Rule 2-01(c)(4)(i) of Regulation S-X provides that prohibited non-audit services include bookkeeping or other services related to the accounting records or financial statements of the audit client, and defines such services as:

Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client’s financial statements, including:

(A) Maintaining or preparing the audit client’s accounting records;

(B) Preparing the audit client’s financial statements that are filed with the Commission or that form the basis of financial statements filed with the Commission; or

(C) Preparing or originating source data underlying the audit client's financial statements.

e. Rule 2-01(c)(4)(i) of Regulation S-X specifically prohibits an audit firm from preparing an audit client's financial statements that are filed with the Commission. In this context, preparing financial statements includes but is not limited to: aggregating line items from internal books and records to the financial statements; changing line item descriptions; drafting or editing notes to the financial statements; and converting FOCUS reports or bookkeeping software program reports into financial statements. With respect to the audit of Broker-Dealer A, and the additional audits in which Liberfarb engaged in substantially similar conduct, Liberfarb engaged in one or more of the above prohibited actions.

f. As a result of Liberfarb's conduct in preparing the financial statements, including the notes thereto, Liberfarb was not independent of its broker-dealer audit clients under the independence criteria established by Rule 2-01(c)(4) of Regulation S-X, which Exchange Act Rule 17a-5 made applicable to the audits of broker-dealer financial statements. As the Commission explained in adopting Rule 2-01(c)(4), providing such services for an audit client "impairs the auditor's independence because the auditor will be placed in the position of auditing the firm's work when auditing the client's financial statements. . . . In addition, keeping the books is a management function, the performance of which leads to an inappropriate mutuality of interests between the auditor and the audit client." *Revision of the Commission's Auditor Independence Requirements*, Exchange Act Release No. 43602, at IV.D.4.b(i) (November 21, 2000). *See also Strengthening the Commission's Requirements Regarding Auditor Independence*, Exchange Act Release No. 47265 ("keeping the books is a management function, which also is prohibited")(January 28, 2003).

g. Liberfarb violated Exchange Act Rule 17a-5(i) by representing in its audit reports that it had performed the audits of the broker-dealers' financial statements in accordance with GAAS when in fact, because of the independence impairment described above, the audits had not been performed in accordance with GAAS.

h. Exchange Act Section 17(a) and Rule 17a-5 require broker-dealers to file annual reports containing financial statements audited by independent public accountants. No showing of scienter is necessary to establish a violation of Exchange Act Section 17(a)(1). *See In the Matter of Orlando Joseph Jett*, Exchange Act Release No. 49366 at n.45 (March 5, 2004) (citing *SEC v. Drexel Burham Lambert Inc.*, 837 F. Supp. 587, 610 (S.D.N.Y. 1993); *Stead v. SEC*, 444 F.2d 713, 716-17 (10th Cir. 1971), *cert denied*, 404 U.S. 1059 (1972)).

i. Under Section 21C of the Exchange Act, a person is a "cause" of another's primary violation if the person knew or should have known that his act or omission would contribute to the primary violation. Negligence is sufficient to establish "causing" liability under Section 21C when a person is alleged to have caused a primary violation that does not require scienter. *In re KPMG*

*Peat Marwick*, Exchange Act. Rel. No. 43862 (Jan. 19, 2001), *aff'd*, *KPMG v. SEC*, 289 F.3d 109 (D.C. Cir. 2002).

j. Liberfarb caused its broker-dealer audit clients to violate Exchange Act Section 17(a) and Rule 17a-5. Liberfarb, an audit firm registered with the PCAOB and operated by a Certified Public Accountant, knew or should have known that its conduct contributed to its audit clients' violations of Exchange Act Section 17(a) and Rule 17a-5.

k. Rule 102(e) of the Commission's Rules of Practice allows the Commission to censure a person if it finds that such person has engaged in "improper professional conduct." Exchange Act § 4C(a)(2); Rule 102(e)(1)(ii). Rule 102(e) defines improper professional conduct, in part, as: "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm or associated person knows, or should know, that heightened scrutiny is warranted." Exchange Act § 4C(b)(2); Rule 102(e)(1)(iv)(B).

l. Questions regarding an auditor's independence always warrant heightened scrutiny. *See* Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57164, 57168 (Oct. 26, 1998) (codified at 17 C.F.R. Part 201). The Commission has defined the "highly unreasonable" standard as:

an intermediate standard, higher than ordinary negligence but lower than the traditional definition of recklessness used in cases brought under Section 10(b) of the Exchange Act and Rule 10b-5 of the Exchange Act. The highly unreasonable standard is an objective standard. The conduct at issue is measured by the degree of the departure from professional standards and not the intent of the accountant.

*Id.* at 57,167; *see also In the Matter of Ernst & Young LLP*, Admin. Proc. File No. 3-10933, SEC Initial Decision Release No. 249, at 60 (Apr. 16, 2004).

m. Based on the conduct set forth above, Liberfarb engaged in highly unreasonable conduct that resulted in violations of applicable professional standards when it knew or should have known that heightened scrutiny was required.

### 3. Findings

a. Based on the foregoing, the Commission finds that Liberfarb engaged in improper professional conduct pursuant to Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

b. Based on the foregoing, the Commission finds that Liberfarb committed violations of Exchange Act Rule 17a-5(i) and caused 20 broker-dealers' violations of Section 17(a) and Rule 17a-5 promulgated thereunder.

**4. Respondent's Remedial Efforts**

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent.

**5. Undertakings**

Liberfarb undertakes:

a. within ninety (90) days from the date of the Order, to establish written policies and procedures, or to revise and/or supplement existing written policies and procedures, for the purpose of providing Liberfarb with reasonable assurance of compliance with applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement (defined to mean an engagement to provide a report – whether an audit report, an examination report, or a review report – required under Exchange Act Rule 17a-5(d)(1)(i)(C), as amended);

b. within ninety (90) days from the date of the Order, to establish a policy of ensuring training, whether internal or external, on an annual or more frequent regular basis, concerning applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement, of any Firm audit personnel who participate in any way in the planning or performing of any SEC Registered Broker-Dealer Engagement;

c. within ninety (90) days from the date of the Order and before Liberfarb's commencement of any SEC Registered Broker-Dealer Engagement (or, where Liberfarb by the date of this Order has already commenced but not completed such an engagement, before Liberfarb's release of its report), to ensure training pursuant to the policy described in paragraph (5)(b) above has been provided on at least one occasion;

d. to provide a copy of the Order –

(i) within thirty (30) days from the date of the Order, to all audit personnel employed by, or associated with (as defined in PCAOB Rule 1001(p)(i)), Liberfarb as of the date of the Order; and

(ii) within thirty (30) days from the date of the Order, to any client of Liberfarb as of the date of the Order for which Liberfarb has performed or has been engaged to perform an SEC Registered Broker-Dealer Engagement;

e. to certify, in writing, compliance with the undertakings set forth above in paragraphs 5(a) through 5(d)(ii). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further

evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Stephen L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5553, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than one hundred twenty (120) days from the date of the Order.

#### IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Liberfarb's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

- A. Liberfarb is hereby censured.
- B. Liberfarb shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-5 promulgated thereunder.
- C. Liberfarb shall comply with the undertakings enumerated in Section (III)(C)(5) above.
- D. Liberfarb shall pay a civil money penalty in the amount of \$30,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). Payment shall be made in the following installments: \$7,500 within ten days of the entry of this Order; \$7,500 within 120 days of the entry of this Order; \$7,500 within 240 days of the entry of this Order; and \$7,500 within 360 days of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:
  - (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
  - (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
  - (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Larry D. Liberfarb, P.C. as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Stephen L. Cohen, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-5553.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: Jill M. Peterson  
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-76421; File No. SR-OCC-2015-804)

November 10, 2015

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of an Advance Notice to Modify The Options Clearing Corporation's Margin Methodology by Incorporating Variations in Implied Volatility

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Payment, Clearing and Settlement Supervision Act")<sup>1</sup> and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934,<sup>2</sup> notice is hereby given that on October 5, 2015, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the advance notice as described in Items I and II below, which Items have been prepared by OCC.<sup>3</sup> The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

This advance notice is filed by The Options Clearing Corporation ("OCC") in connection with a proposed change that would modify OCC's margin methodology by incorporating variations in implied volatility for "shorter tenor" options within the System for Theoretical Analysis and Numerical Simulations ("STANS").

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<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

<sup>3</sup> OCC also filed a proposed rule change with the Commission pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 and Rule 19b-4 thereunder, seeking approval of changes to its rules necessary to implement the proposal. 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4, respectively. See SR-OCC-2015-016.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections (A) and (B) below, of the most significant aspects of these statements.

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants or Others

Written comments were not and are not intended to be solicited with respect to the proposed change and none have been received.

(B) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

**Description of the Proposed Change**

The proposed change would modify OCC's margin methodology by more broadly incorporating variations in implied volatility within STANS. As explained below, OCC believes that expanding the use of variations in implied volatility within STANS for substantially all<sup>4</sup> option contracts available to be cleared by OCC that have a residual

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<sup>4</sup> OCC is proposing to exclude: (i) binary options, (ii) options on energy futures, and (iii) options on U.S. Treasury securities. These relatively new products were introduced as the implied volatility margin methodology changes were in the process of being completed by OCC. Subsequent to the implementation of the revised implied volatility margin methodology discussed in this filing, OCC would plan to modify the margin methodology to accommodate the above new products. In addition, due to *de minimus* open interest in those options, OCC does not believe there is a substantive risk if the products would be excluded from the implied volatility margin methodology modifications at this time.

tenor<sup>5</sup> of less than three years (“Shorter Tenor Options”) would enhance OCC’s ability to ensure that option prices and the margin coverage related to such positions more appropriately reflect possible future market value fluctuations and better protect OCC in the event it must liquidate the portfolio of a suspended Clearing Member.

*Implied Volatility in STANS Generally*

STANS is OCC’s proprietary risk management system that calculates Clearing Members’ margin requirements in accordance with OCC’s Rules.<sup>6</sup> The STANS methodology uses Monte Carlo simulations to forecast price movement and correlations in determining a Clearing Member’s margin requirement. Under STANS, the daily margin calculation for each Clearing Member account is constructed to comply with Commission Rule 17Ad-22(b)(2),<sup>7</sup> ensuring OCC maintains sufficient financial resources to liquidate a defaulting member’s positions, without loss, within the liquidation horizon of two business days.

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<sup>5</sup> The “tenor” of an option is the amount of time remaining to its expiration.

<sup>6</sup> Pursuant to OCC Rule 601(e)(1), however, OCC uses the Standard Portfolio Analysis of Risk Margin Calculation System (“SPAN”) to calculate initial margin requirements for segregated futures accounts. No changes are proposed to OCC’s use of SPAN because the proposed changes do not concern futures. *See* Securities Exchange Act Release No. 72331 (June 5, 2014), 79 FR 33607 (June 11, 2014) (SR-OCC-2014-13).

<sup>7</sup> 17 CFR 240.17Ad-22(b)(2). As a registered clearing agency that performs central counterparty services, OCC is required to “use margin requirements to limit its credit exposures to participants under normal market conditions and use risk-based models and parameters to set margin requirements and review such margin requirements and the related risk-based models and parameters at least monthly.”

The STANS margin requirement for an account is composed of two primary components:<sup>8</sup> a base component and a stress test component. The base component is obtained from a risk measure of the expected margin shortfall for an account that results under Monte Carlo price movement simulations. For the exposures that are observed regarding the account, the base component is established as the estimated average of potential losses higher than the 99% VaR<sup>9</sup> threshold to help ensure that OCC continuously meets the requirements of Rule 17Ad-22(b)(2).<sup>10</sup> In addition, OCC augments the base component using the stress test component. The stress test component is obtained by considering increases in the expected margin shortfall for an account that would occur due to (i) market movements that are especially large and/or in which certain risk factors would exhibit perfect or zero correlations rather than correlations otherwise estimated using historical data or (ii) extreme and adverse idiosyncratic movements for individual risk factors to which the account is particularly exposed.

Including variations in implied volatility within STANS is intended to ensure that the anticipated cost of liquidating each Shorter Tenor Option position in an account

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<sup>8</sup> The two primary components referenced relate to the risk calculation and are associated with the 99% two-day expected shortfall (i.e., ES) and the concentration/dependence margin add-on (i.e., Add-on Charge). When computing the ES or Add-on Charges, STANS computes the theoretical value of an option for a given simulated underlying price change using the implied volatility reflected in the prior day closing price. Under the proposed change, STANS would use a modeled implied volatility intended to simulate the estimated change in implied volatilities given the simulated underlying price change in STANS.

<sup>9</sup> The term "value at risk" or "VaR" refers to a statistical technique that, generally speaking, is used in risk management to measure the potential risk of loss for a given set of assets over a particular time horizon.

<sup>10</sup> 17 CFR 240.17Ad-22(b)(2).

recognizes the possibility that implied volatility could change during the two business day liquidation time horizon in STANS and lead to corresponding changes in the market prices of the options. Generally speaking, the implied volatility of an option is a measure of the expected future volatility of the value of the option's annualized standard deviation of the price of the underlying security, index, or future at exercise, which is reflected in the current option premium in the market. The volatility is "implied" from the premium for an option<sup>11</sup> at any given time by calculating the option premium under certain assumptions used in the Black-Scholes options pricing model and then determining what value must be added to the known values for all of the other variables in the Black-Scholes model to equal the premium. In effect, the implied volatility is responsible for that portion of the premium that cannot be explained by the then-current intrinsic value<sup>12</sup> of the option, discounted to reflect its time value. OCC currently incorporates variations in implied volatility as risk factors for certain options with residual tenors of at least three years ("Longer Tenor Options").<sup>13</sup>

*Implied Volatility for Shorter Tenor Options*

OCC is proposing certain modifications to STANS to more broadly incorporate variations in implied volatility for Shorter Tenor Options. Consistent with its approach

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<sup>11</sup> The premium is the price that the holder of an option pays and the writer of an option receives for the rights conveyed by the option.

<sup>12</sup> Generally speaking, the intrinsic value is the difference between the price of the underlying and the exercise price of the option.

<sup>13</sup> See Securities Exchange Act Release Nos. 68434 (December 14, 2012), 77 FR 57602 [sic] (December 19, 2012) (SR-OCC-2012-14); 70709 [sic] (October 18, 2013), 78 FR 63267 [sic] (October 23, 2013) [sic] (SR-OCC-2013-16).

for Longer Tenor Options, OCC would model a volatility surface<sup>14</sup> for Shorter Tenor Options by incorporating into the econometric models underlying STANS certain risk factors regarding a time series of proportional changes in implied volatilities for a range of tenors and absolute deltas. Shorter Tenor Option volatility points would be defined by three different tenors and three different absolute deltas, which produce nine “pivot points.” In calculating the implied volatility values for each pivot point, OCC would use the same type of series-level pricing data set to create the nine pivot points that it does to create the larger number of pivot points used for Longer Tenor Options, so that the nine pivot points would be the result of a consolidation of the entire series-level dataset into a smaller and more manageable set of pivot points before modeling the volatility surface.

OCC partnered with an experienced vendor in this area to study implied volatility surfaces and to use back-testing of OCC’s margin requirements to build a model that would be appropriately sophisticated and operate conservatively to minimize margin exceedances. The back-testing results support that, over a look-back period from January 2008 to May 2013,<sup>15</sup> using nine pivot points to define the volatility surface would have resulted in a comparable number of instances in which an account containing certain hypothetical positions would have been under-margined compared to using a larger

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<sup>14</sup> The term “volatility surface” refers to a three-dimensional graphed surface that represents the implied volatility for possible tenors of the option and the implied volatility of the option over those tenors for the possible levels of “moneyness” of the option. The term “moneyness” refers to the relationship between the current market price of the underlying interest and the exercise price.

<sup>15</sup> The look-back period was determined based on the availability of relevant data at the time of the back-testing. Relevant data in this case means data obtained from OCC’s consultants, Finance Concepts. The back-testing was performed by Finance Concepts using data from their OptionMetrics Ivy source. The Ivy source maintains data from prior to 2008, but it is not clear that data from before the market dislocation in early August 2007 is as relevant to today’s options markets.

number of pivot points to define the volatility surface. Therefore, although OCC could create a more detailed volatility surface by increasing the number of pivot points, OCC has determined that doing so for Shorter Tenor Options would not be appropriate. Moreover, due to the significantly larger volume of Shorter Tenor Options, OCC also believes that relying on a greater number of pivot points could potentially lead to increases in the time necessary to compute margin requirements that would impair OCC's capacity to make timely calculations.

Under OCC's model for Shorter Tenor Options, the volatility surfaces would be defined using tenors of one month, three months, and one year with absolute deltas, in each case, of 0.25, 0.5, and 0.75. This results in the nine implied volatility pivot points. Given that premiums of deep-in-the-money options (those with absolute deltas closer to 1.0) and deep-out-of-the-money options (those with absolute deltas closer to 0) are insensitive to changes in implied volatility, in each case notwithstanding increases or decreases in implied volatility over the two business day liquidation time horizon, those higher and lower absolute deltas have not been selected as pivot points. OCC believes that it is appropriate to focus on pivot points representing at- and near-the-money options because prices for those options are more sensitive to variations in implied volatility over the liquidation time horizon of two business days. Specifically, for SPX index options, four factors explain 99% variance of implied volatility movements: (i) a parallel shift of the entire surface, (ii) a slope or skewness with respect to Delta, (iii) a slope with respect to time to maturity; and, (iv) a convexity with respect to the time to maturity. The nine correlated pivot points, arranged by delta and tenor, give OCC the flexibility to capture these factors.

In the proposed approach to computing margin for Shorter Tenor Options under STANS, OCC would first use its econometric models to simulate implied volatility changes at the nine pivot points that would correspond to underlying price simulations used by STANS.<sup>16</sup> For each Shorter Tenor Option in the account of a Clearing Member, changes in its implied volatility would then be simulated according to the corresponding pivot point and the price of the option would be computed to determine the amount of profit or loss in the account under the particular STANS price simulation. Additionally, as OCC does today, it would continue to use simulated closing prices for the assets underlying options in the account of a Clearing Member that are scheduled to expire within the liquidation time horizon of two business days to compute the options' intrinsic value<sup>17</sup> and use those values to help calculate the profit or loss in the account.<sup>18</sup>

#### *Effects of the Proposed Change and Implementation*

OCC believes that the proposed change would enhance OCC's ability to ensure that in determining margin requirements STANS appropriately takes into account normal market conditions that OCC may encounter in the event that, pursuant to OCC Rule 1102, it suspends a defaulted Clearing Member and liquidates its accounts.<sup>19</sup> Accordingly, the

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<sup>16</sup> STANS relies on 10,000 price simulation scenarios that are based generally on a historical data period of 500 business days, which is updated monthly to keep model results from becoming stale.

<sup>17</sup> Generally speaking, the intrinsic value is the difference between the price of the underlying and the exercise price of the option.

<sup>18</sup> For such Shorter Tenor Options that are scheduled to expire on the open of the market rather than the close, OCC would use the relevant opening price for the underlying assets.

<sup>19</sup> Under authority in OCC Rules 1104 and 1106, OCC has authority to promptly liquidate margin assets and options positions of a suspended Clearing Member in

change would promote OCC's ability to ensure that margin assets are sufficient to liquidate the accounts of a defaulted Clearing Member without incurring a loss.

OCC estimates that Clearing Member accounts generally would experience increased margin requirements as compared to those calculated for the same options positions in an account today. OCC estimates the proposed change would most significantly affect customer accounts and least significantly affect firm accounts, with the effect on Market Maker accounts falling in between.

OCC expects customer accounts to experience the largest margin increases because positions considered under STANS for customer accounts typically consist of more short than long options positions, and therefore reflect a greater magnitude of direction risk than other account types. Positions considered under STANS for customer accounts typically consist of more short than long options positions because, to facilitate Clearing Members' compliance with Commission requirements for the protection of certain customer property under Rule 15c3-3(b),<sup>20</sup> OCC segregates long option positions in the securities customers' account of each Clearing Member and does not assign them any value in determining the expected liquidating value of the account.<sup>21</sup>

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the most orderly manner practicable, which might include, but would not be limited to, a private auction.

<sup>20</sup> 17 CFR 240.15c3-3(b).

<sup>21</sup> See OCC Rule 601(d)(1). Pursuant to OCC Rule 611, however, a Clearing Member, subject to certain conditions, may instruct OCC to release segregated long option positions from segregation. Long positions may be released, for example, if they are part of a spread position. Once released from segregation, OCC receives a lien on each unsegregated long securities option carried in a customers' account and therefore OCC permits the unsegregated long to offset corresponding short option positions in the account.

While overall OCC expects an increase in aggregate margins by about \$1.5 billion (9% of expected shortfall and stress-test add-on), OCC does anticipate a decrease in margins in certain clearing member accounts' requirements. OCC anticipates that such a decrease would occur in accounts with underlying exposure and implied volatility exposure in the same direction, such as concentrated call positions, due to the negative correlation typically observed between these two factors. Over the back-testing period, about 28% of the observations for accounts on the days studied had lower margins under the proposed methodology and the average reduction was about 2.7%. Parallel results will be made available to the membership in the weeks ahead of implementation.

To help Clearing Members prepare for the proposed change, OCC has provided Clearing Members with an Information Memo explaining the proposal, including the planned timeline for its implementation,<sup>22</sup> and discussed with certain other clearinghouses the likely effects of the change on OCC's cross-margin agreements with them. OCC is also publishing an Information Memo to notify Clearing Members of the submission of this filing to the Commission. Subject to all necessary regulatory approvals regarding the proposed change, for a period of at least two months beginning in October 2015, OCC intends to begin making parallel margin calculations with and without the changes in the margin methodology. The commencement of the calculations

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<sup>22</sup> In addition to the proposal to introduce variations in implied volatility for Shorter Tenor Options, OCC is also contemporaneously proposing an additional change to its margin methodology that would use liquidity charges to account for certain costs associated with hedging in which OCC would engage during a Clearing Member liquidation and the reasonably expected effect that OCC's management of the liquidation would have on related bid-ask spreads in the marketplace. The Information Memo explained both of these proposed changes and their expected effects on margin requirements.

would be announced by an Information Memo, and OCC would provide the calculations to Clearing Members each business day. OCC believes that Clearing Members will have sufficient time and data to plan for the potential increases in their respective margin requirements. OCC would also provide at least thirty days prior notice to Clearing Members before implementing the change.

**Consistency with the Payment, Clearing and Settlement Supervision Act**

OCC believes that the proposed change regarding the incorporation of variations in implied volatility within STANS is consistent with Section 805(b)(1) of the Payment, Clearing and Settlement Supervision Act<sup>23</sup> because the proposed procedures would promote robust risk management by more robustly computing Clearing Member margin requirements in order to ensure that OCC maintains adequate financial resources in the event of a Clearing Member default. As described above, OCC believes that the proposed change would enhance OCC's ability to ensure that margin requirements determined through STANS appropriately take into account normal market conditions that OCC may encounter in the event that, pursuant to OCC Rule 1102, it suspends a defaulted Clearing Member and liquidates its accounts. As a result, OCC would be better able to ensure that margin assets are sufficient to liquidate the accounts of a defaulted Clearing Member without incurring a loss and thereby promote robust risk management.

**Anticipated Effect on and Management of Risk**

OCC believes that the proposed change would reduce OCC's overall level of risk because the proposed change makes it less likely that the amount of margin OCC collects from Clearing Members Clearing Fund would be insufficient should OCC need to use

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<sup>23</sup> 12 U.S.C. 5464(b)(1).

such margin in connection with a Clearing Member default. As described above, OCC is proposing certain modifications to STANS to more broadly incorporate variations in implied volatility for Shorter Tenor Options. Such modifications would result in OCC being able to better ensure that margin requirements computed by STANS because [sic] STANS would appropriately take into account normal market conditions that OCC may encounter in the event that, pursuant to OCC Rule 1102, it suspends a defaulted Clearing Member and liquidates its accounts. As a result, the proposed change would make it less likely that OCC would need to use additional financial resources, such as its clearing fund, in order to appropriately manage a clearing member default. Moreover, the proposed change is intended to measure the exposure associated with changes in option implied volatilities, thus mitigating credit risk presented by clearing members.

Accordingly, OCC believes that the proposed changes would reduce risks to OCC and its participants. Moreover, and for the same reasons, the proposed change will facilitate OCC's ability to manage risk.

### III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The designated clearing agency may implement this change if it has not received an objection to the proposed change within 60 days of the later of (i) the date that the Commission receives the notice of proposed change, or (ii) the date the Commission receives any further information it requests for consideration of the notice. The designated clearing agency shall not implement this change if the Commission has an objection.

The Commission may, during the 60-day review period, extend the review period for an additional 60 days for proposed changes that raise novel or complex issues, subject

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

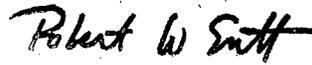
All submissions should refer to File Number SR-OCC-2015-804. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website

(<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office OCC and on OCC's website at

[http://www.optionsclearing.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_2015\\_804.pdf](http://www.optionsclearing.com/components/docs/legal/rules_and_bylaws/sr_occ_2015_804.pdf). All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only

information that you wish to make available publicly. All submissions should refer to File Number SR-OCC-2015-804 and should be submitted on or before [insert date 15 days from publication in the Federal Register].

By the Commission.



Robert W. Errett  
Deputy Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 76432 / November 12, 2015**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4262 / November 12, 2015**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 31900 / November 12, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16955**

**In the Matter of**

**METIS WEALTH  
ADVISORS, LLC and  
JUAN R. MONTERMOSO,**

**Respondents.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTIONS 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
SECTIONS 203(e), 203(f) AND 203(k) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
AND SECTION 9(b) OF THE INVESTMENT  
COMPANY ACT OF 1940, MAKING  
FINDINGS, AND IMPOSING REMEDIAL  
SANCTIONS AND A CEASE-AND-DESIST  
ORDER**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Metis Wealth Advisors, LLC and Juan R. Montermoso (collectively, "Respondents").

**II.**

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings

13 of 33

Pursuant to Sections 21C of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

### III.

On the basis of this Order and Respondents’ Offer, the Commission finds that:

#### Respondents

1. Juan R. Montermoso (“Montermoso”), age 43, is a resident of Issaquah, Washington. He is a former Financial Industry Regulatory Authority (“FINRA”) registered representative who held Series 7, 24, 31, 63, and 65 licenses. From 2003 until July 2010, Montermoso was associated sequentially with two different registered broker-dealers, subsequent to which Montermoso contracted with a third registered broker-dealer for custodial, execution, clearing and back-office services in connection with the investment advisory firm he formed in 2010: Metis Wealth Advisors, LLC. In November 2011, FINRA permanently barred Montermoso for failing to respond to its requests for information pursuant to FINRA Rule 8210.

2. Metis Wealth Advisors, LLC (“Metis”) was registered in Virginia as an investment adviser during the period July 2010 through December 2010. Montermoso was Metis’s owner, president, chief investment officer, and managing member. From July 2010 until June 2014, Montermoso conducted an investment advisory business through Metis. From July 2010 until December 2011, a registered broker-dealer executed transactions ordered by Montermoso in Metis client accounts.

#### Background

3. After working as a broker at two different firms for seven years, in July 2010 Montermoso began conducting investment advisory business through his newly-formed Metis Wealth Advisors, LLC. Montermoso registered Metis as an investment adviser in Virginia and transferred approximately 40 accounts to the new firm. He entered into an arrangement with a broker-dealer to execute trades for Metis and provide back-office services to it.

4. In September 2010, shortly after Montermoso formed Metis, one of his clients at his previous firm, (“Client 1”), had a \$28,000 portfolio containing securities that were traded on the NYSE or NASDAQ. Client 1 told Montermoso she wanted to sell the investments and transfer the proceeds to her savings account. Montermoso omitted to inform her that she could instruct her brokerage firm—the one Montermoso had recently left—to sell the securities from her account and remit the sale proceeds to her bank account. Instead, he persuaded Client 1 to transfer her account to Metis so that he could “manage the liquidations after the transfer.” Montermoso assured her the securities in the account would be liquidated and the sale proceeds transferred to her bank account, all within a few days of the account being transferred. Client 1 followed Montermoso’s advice and transferred her account to Metis in September 2010.

5. Contrary to Montermoso's assurance, he did not immediately sell all of the securities or send her the proceeds. He sold one of the securities in early October, but Client 1 did not receive the first payment, a check for about one-third of the value of the account before the transfer, until October 31, 2010. She received a second payment in December 2010. But this time the payment did not come from Client 1's brokerage account. Rather, Montermoso wired it from his personal bank account. Montermoso made two more payments to Client 1 from his personal bank account in February 2011—six months after she instructed him to liquidate her account. The value of the account continued to decline due to the decline in value of underlying investments and due to fees withdrawn by Metis's back-office firm. Montermoso did not complete the sales of the securities until August 2011, after which \$5,812.95 remained in the account. Montermoso ordered the liquidation of the securities in order to draw the remaining funds, which he deemed to be an investment advisory fee and transfer them to his personal account. He then instructed the broker-dealer to close the account. If Montermoso had liquidated Client 1's account in September 2010, when ordered to do so, he would not have been entitled to this fee, and the client would have received the full balance of her account at that time.

6. On December 31, 2010, Metis' investment advisory registration in Virginia lapsed and Montermoso failed to renew it. Montermoso omitted to inform his clients that Metis's registration had lapsed, but continued to maintain his advisory relationship with Client 1 through August 2011. He also continued to maintain his advisory relationship with his other clients through December 2011, except in the case of Client 2, discussed below. In November 2011, FINRA barred Montermoso after he failed to respond to its information request arising from a dispute Montermoso had with a former client. Montermoso omitted to inform his clients of the FINRA bar. In December 2011, after learning of these events, the broker-dealer with which Metis contracted to execute its clients' transactions terminated its relationship with Metis.

7. Another Metis/Montermoso client, ("Client 2"), a retired widow, had for a number of years been drawing from her account monthly cash distributions of \$5,000 or more. By 2010, however, her portfolio value had diminished to the point that her assets could not generate the cash for distributions. Rather than informing Client 2 that she could not afford the distributions, in September 2010 Metis and Montermoso began wiring her cash each month from Montermoso's personal bank account while leading her to believe that her own assets were the source of the distributions. By June 2014, Montermoso had transferred more than \$320,000 to Client 2. These transfers of money led her to believe for over three years that she held assets that would support a more extravagant lifestyle than she could in fact afford. Montermoso transferred an additional \$187,500 to Client 2 to settle her potential claims, such that the total that Montermoso transferred to Client 2 from his personal account totaled more than \$507,000.

8. From 2012 until June 2014, Metis and Montermoso misled Client 2 into believing that he was still a registered representative, that Metis was still a registered investment adviser, and that she remained Metis' investment advisory client. Specifically, he omitted to inform her that he had been barred by FINRA, and continued his advisory relationship with her after November 2011.

9. By July 2012, Client 2's two brokerage accounts held assets worth \$25,000 and \$67,000, respectively. At that time, Montermoso communicated to her that "[f]ortunately, we are ahead of pace for the year which means I can afford to take additional cash over and above the \$5000 monthly withdrawal." In the same communication, Montermoso told Client 2 that she had another brokerage account worth \$271,000, as well as a bond fund worth \$68,000. Neither the brokerage account nor the bond fund existed.

10. To further the illusion that Client 2's assets were generating the distributions, Montermoso created a phantom brokerage account in the client's name. He did so by providing her with an Automated Customer Account Transfer Service ("ACATS") form<sup>1</sup> for the brokerage firm to which her holdings were ostensibly being transferred, fabricating account statements and periodically emailing them to her, as well as emailing her regarding the amount and nature of the nonexistent holdings. The account statements, which bore the legend of Metis Wealth Advisors, purported to reflect her securities holdings, the securities transactions through her account and its value. The list of securities that appeared on the account statements was fictitious and the securities transactions described in them never took place. The first fictitious account statement, purporting to cover the period ended June 2012, reflected investments worth \$333,000. A later fictitious account statement—purporting to cover the period ended May 2014—reflected that Client 2's assets had grown dramatically in less than two years, to \$624,000. During this period, Metis and Montermoso continued to advise Client 2 on investing in, purchasing, or selling securities and, in communications with her, misrepresented that Metis was still a registered investment adviser.

11. As a result of the conduct described above, Montermoso and Metis willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

12. As a result of the conduct described above, Montermoso and Metis willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser.

13. As a result of the conduct described above, Montermoso willfully aided and abetted and caused Metis's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct in connection with the purchase or sale of securities and prohibit fraudulent conduct by an investment adviser, respectively.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offer.

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<sup>1</sup> ACATS is a system that facilitates the transfer of securities from one trading account to another at a different brokerage firm or bank.

Accordingly, pursuant to Sections 21C of the Exchange Act, Sections 203(e), 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondents cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act.

B. Respondent Metis is censured; and

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

C. Respondent Monterroso be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

D. Any reapplication for association by the Respondents will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondents, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

E. Respondents shall, jointly and severally, pay disgorgement of \$5,812.95, which represents profits gained as a result of the conduct described herein, prejudgment interest of \$677.97 and civil penalties of \$65,000.00 to the Securities and Exchange Commission. Payment shall be made in the following installments:

- 1) Within 14 days of the entry of this Order, disgorgement of \$5,812.95, prejudgment interest of \$677.97 and penalties of \$17,872.73;
- 2) Within 180 days of the entry of this Order, penalties of \$29,254.54; and

3) Within 365 days of the entry of this Order, penalties of \$17,872.73.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600, or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

- (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Montermoso and Metis as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Stephen L. Cohen, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5553.

F. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, interest, and penalties referenced in paragraph E above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in these proceedings. For

purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in these proceedings.

G. After receipt of the disgorgement, interest, and penalties referenced in paragraph E above, the Commission shall, within 30 days, make a payment of \$5,885.55 (the disgorgement amount of \$5812.95 plus interest in the amount of \$72.60, calculated at the Federal short-term rate) to Client 1. The Commission staff will seek the appointment of a tax administrator in regard to the payment to Client 1 as it constitutes a payment from a qualified settlement fund ("QSF") under section 468B(g) of the Internal Revenue Code (IRC), 26 U.S.C. § 468B(g), and related regulations, 26 C.F.R. §§ 1.468B-1 through 1.468B-5. Taxes, if any, and related administrative expenses shall be paid from the funds remaining after the payment has been made to Client 1. After the distribution payment and all taxes and administrative expenses are paid, the Commission staff will transfer the remaining funds to the general fund of the United States Treasury subject to Exchange Act Section 21F(g)(3).

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent Montermoso, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent Montermoso under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent Montermoso of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields  
Secretary

*Will M. Peterson*  
By: Will M. Peterson  
Assistant Secretary

*Commissioner Pinowar  
Not participating*

**UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934  
Release No. 76435 / November 13, 2015**

**INVESTMENT ADVISERS ACT OF 1940  
Release No. 4263 / November 13, 2015**

**ADMINISTRATIVE PROCEEDING  
File No. 3-16956**

**In the Matter of**

**KEVIN C. BROWN,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 15(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
AND SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Kevin C. Brown ("Brown" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section

15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent’s Offer, the Commission finds that:

1. Brown was the president, director and sole owner of the common stock of Summit Trust Company (“STC”), a Nevada-chartered trust company. Brown was also the president, owner, and managing member of Rampart Capital Management, LLC (“RCM”), an unregistered investment adviser to the Rampart Fund LP (“Rampart Fund”), a private fund. In addition, Brown was the president of Trust Counselors Network, Inc. (“TCN”), a charitable organization registered under Section 501(c)(3) of the Internal Revenue Code. Finally, Brown was the president, part owner, and an investment adviser representative of Brown Investment Advisors, Inc. (“BIA”), an investment adviser registered with the states of Pennsylvania and New Jersey. Brown, 49 years old, is a resident of Hilltown, Pennsylvania.

2. On November 5, 2015, a final judgment was entered by consent against Brown, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, Sections 206(1), (2), (3), and (4) of the Advisers Act and Rule 206(4)-8 thereunder, and Section 7(a) of the Investment Company Act of 1940, in the civil action entitled Securities and Exchange Commission v. Summit Trust Company, et al., Civil Action Number 15-cv-05843-JCJ, in the United States District Court for the Eastern District of Pennsylvania.

3. The Commission’s complaint alleged that Brown participated in three multi-million dollar offering frauds through the various entities he owned and/or controlled. First, between approximately 2008 and 2014, Brown helped STC raise over \$33 million in a preferred stock offering based upon representations that the proceeds would be used to open additional trust offices and to acquire other assets under management from trust or advisory firms. In fact, Brown and STC used millions of dollars for other purposes, such as paying other STC investors’ preferred stock dividends and redemptions and making payments to Brown’s other affiliated entities. Second, between approximately 2008 and 2013, Brown, acting through RCM, BIA, and STC, helped the Rampart Fund raise approximately \$7.9 million in a promissory notes offering for the purported purpose of investing in mezzanine debt financing programs. However, Brown concealed from investors the default by the Rampart Fund’s primary underlying investment and his use of new investor proceeds to pay interest and redemptions due to other Rampart Fund investors. On behalf of the Rampart Fund, Brown also used Fund proceeds to purchase securities which were issued by entities that he owned and controlled without providing disclosure and obtaining effective consent from the Rampart Fund. In addition, he substantially assisted the Rampart Fund in offering and selling securities as an unregistered investment company. Third, from approximately 2004 through 2015, Brown helped TCN raise over \$12 million from investors for various estate planning products, including charitable gift annuities and charitable installment bargain sales. However, due to losses on TCN’s speculative investments, since approximately 2008, Brown operated TCN like a Ponzi scheme by using funds from new investors to meet TCN’s

older annuity and other obligations. TCN also misappropriated investor funds by paying undisclosed commissions on sales of the estate planning products, transferring cash to BIA, and making a personal loan to Brown. Furthermore, the complaint alleged that Brown engaged in the unregistered offer and sale of the securities of STC, the Rampart Fund, and TCN. Finally, the complaint alleged that he received transaction-based compensation for proactively soliciting investors to purchase certain securities offered on STC's trust platform in violation of the broker-dealer registration provisions of the federal securities laws.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Brown's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act, and Section 203(f) of the Advisers Act, that Respondent Brown be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

Pursuant to Section 15(b)(6) of the Exchange Act Respondent Brown be, and hereby is barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
Assistant Secretary

*Commissioner Pinowar  
Not Participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 4264 / November 13, 2015

ADMINISTRATIVE PROCEEDING  
File No. 3-16957

In the Matter of

**GEORGE P. BROWN,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against George P. Brown ("Brown" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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### III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Brown was the chief marketing officer and a director of Summit Trust Company ("STC"), a Nevada-chartered trust company. Brown was also the vice president, owner, and managing member of Rampart Capital Management, LLC ("RCM"), an unregistered investment adviser to the Rampart Fund LP ("Rampart Fund"), a private fund. In addition, Brown was the vice president and chairman of Trust Counselors Network, Inc. ("TCN"), a charitable organization registered under Section 501(c)(3) of the Internal Revenue Code. Finally, Brown was the chairman, part owner, and investment adviser representative of Brown Investment Advisors, Inc. ("BIA"), an investment adviser registered with the states of Pennsylvania and New Jersey. Brown, 81 years old, is a resident of Chalfont, Pennsylvania.

2. On November 5, 2015, a final judgment was entered by consent against Brown, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, Sections 206(1), (2), (3), and (4) of the Advisers Act and Rule 206(4)-8 thereunder, and Section 7(a) of the Investment Company Act of 1940, in the civil action entitled Securities and Exchange Commission v. Summit Trust Company, et al., Civil Action Number 15-cv-05843-JCJ, in the United States District Court for the Eastern District of Pennsylvania.

3. The Commission's complaint alleged that Brown participated in three multi-million dollar offering frauds through various entities that he owned and/or controlled. First, between approximately 2008 and 2014, Brown helped STC raise over \$33 million in a preferred stock offering based upon representations that the proceeds would be used to open additional trust offices and to acquire other assets under management from trust or advisory firms. In fact, Brown knew that STC used millions of dollars for other purposes, such as paying other STC investors' preferred stock dividends and redemptions and making payments to Brown's other affiliated entities. Second, between approximately 2008 and 2013, Brown, acting through RCM, BIA, and STC, helped the Rampart Fund raise approximately \$7.9 million in a promissory notes offering for the purported purpose of investing in mezzanine debt financing programs. However, Brown concealed from investors the default by the Rampart Fund's primary underlying investment and the Rampart Fund's use of new investor proceeds to pay interest and redemptions due to other Rampart Fund investors. On behalf of the Rampart Fund, Brown also used Fund proceeds to purchase securities which were issued by entities that he owned and controlled without providing disclosure and obtaining effective consent from the Rampart Fund. In addition, he substantially assisted the Rampart Fund in offering and selling securities as an unregistered investment company. Third, from approximately 2004 through 2015, Brown helped TCN raise over \$12 million from investors for various estate planning products, including charitable gift annuities and charitable installment bargain sales. However, due to losses on TCN's speculative investments which Brown knew about, since approximately 2008, TCN was operated like a Ponzi scheme by using funds from new investors to meet TCN's older annuity and other obligations. TCN also misappropriated investor funds by paying undisclosed commissions on sales of the estate planning products, transferring

cash to BIA, and making a personal loan to Brown. Finally, the complaint alleged that Brown engaged in the unregistered offer and sale of the securities of STC, the Rampart Fund, and TCN.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Brown's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act, that Respondent Brown be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By **Jill M. Peterson**  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4266 / November 16, 2015**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 31901 / November 16, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16959**

**In the Matter of**

**VIRTUS INVESTMENT  
ADVISERS, INC.,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS PURSUANT  
TO SECTIONS 203(e) AND 203(k) OF  
THE INVESTMENT ADVISERS ACT OF  
1940, AND SECTIONS 9(b) AND 9(f) OF  
THE INVESTMENT COMPANY ACT  
OF 1940, MAKING FINDINGS, AND  
IMPOSING REMEDIAL SANCTIONS  
AND A CEASE-AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Virtus Investment Advisers, Inc. ("Respondent" or "Virtus").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### Summary

1. This matter arises from misstatements made by registered investment adviser Virtus to certain of its mutual fund clients, to those funds' shareholders, and to clients in separately managed accounts concerning its subadviser F-Squared Investments, Inc.'s ("F-Squared") materially inflated, and hypothetical and back-tested, performance track record.
2. AlphaSector is a sector rotation strategy based on an algorithm that yields a "signal" indicating whether to buy or sell nine industry exchange-traded funds ("ETFs") that together made up the industries in the S&P 500 Index. Between September 2009 and May 2015, Virtus advised six mutual funds and certain separately managed accounts ("SMAs") that used AlphaSector (collectively, the "Virtus AlphaSector Funds"). The Virtus AlphaSector Funds grew quickly, with assets under management increasing from \$191 million at the end of 2009 to approximately \$11.5 billion by 2013.
3. From May 2009 to September 2013, in certain client presentations, marketing materials, filings with the Commission, and other communications, Virtus falsely stated that: (a) the AlphaSector strategy had a history that dated back to April 2001 and had been in use since then; and (b) the track record had significantly outperformed the S&P 500 Index from April 2001 to September 2008. In fact, no F-Squared or other client assets had tracked the strategy from April 2001 through September 2008. In addition, F-Squared miscalculated the historical performance of AlphaSector from April 2001 to September 2008 by incorrectly implementing signals in advance of when such signals actually could have occurred. As a result of this inaccurate compilation of historical data, Virtus advertised the AlphaSector strategy by using hypothetical and back-tested historical performance that was substantially inflated over what performance would have been if F-Squared had applied the signals accurately.
4. Virtus also failed to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder, as required by Section 206(4) of the Advisers Act and Rule 206(4)-7. Specifically, Virtus's compliance policies and procedures with respect to performance advertising and the retention of books and records supporting the performance or rate of return of managed accounts in performance advertisements addressed Virtus's obligations with respect to advertising the performance of Virtus's clients' accounts but not the performance obtained by other advisers or sub-advisers in performance advertisements directly or indirectly circulated or distributed by Virtus. Given its manager of managers business model, Virtus failed to adopt and implement policies and procedures regarding: (a) the accuracy of third-party produced performance information and third-party marketing materials; and (b) the reporting and assessment of concerns about the accuracy of statements in Virtus's marketing materials and other disclosures.

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

As a result, Virtus failed to adopt and implement reasonably designed written policies and procedures regarding the retention of books and records necessary to support the basis for performance information in advertisements directly or indirectly circulated or distributed by Virtus.

5. In addition, Virtus violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder by publishing, circulating, and distributing advertisements that contained untrue statements of material fact. Virtus likewise failed to make and keep true, accurate and current records or documents necessary to form the basis for or demonstrate the calculation of the performance or rate of returns that it circulated and distributed, as required by Section 204 of the Advisers Act and Rule 204-2(a)(16) thereunder.

#### Respondent

6. **Virtus Investment Advisers** (SEC File No. 801-5995) is an investment adviser registered with the Commission since September 1969 and is headquartered in Hartford, Connecticut. Virtus provides advice to mutual funds and separately managed accounts that employ a variety of investment strategies. As of March 31, 2015, Virtus had regulatory assets under management of approximately \$36 billion.

#### Other Relevant Entities

7. **Virtus Investment Partners, Inc.** is the parent company of Virtus and is headquartered in Hartford, Connecticut. The common stock of Virtus Investment Partners is registered pursuant to Section 12(b) of the Securities Exchange Act of 1934 and is listed for trading on NASDAQ using the ticker VRTS.

8. **F-Squared Investments, Inc.** ("F-Squared") (SEC File No. 801-69937) is an investment adviser registered with the Commission since March 2009 and is headquartered in Wellesley, Massachusetts. In October 2008, F-Squared launched its first AlphaSector index. F-Squared sub-licenses its approximately 75 AlphaSector indexes to unaffiliated third parties who manage assets pursuant to these indexes. On December 22, 2014, the Commission instituted a settled fraud action against F-Squared in which F-Squared admitted, among other things, to making the materially false claims that (a) the signals that formed the basis of the AlphaSector index returns had been used to manage client assets from April 2001 to September 2008; and (b) the signals resulted in a track record that significantly outperformed the S&P 500 Index from April 2001 to September 2008.

9. **Howard Brian Present** ("Present"), age 54, resides in Wellesley, Massachusetts. In 2006, Present co-founded F-Squared and was the President and CEO until his separation in 2014. As of August 2015, Present owned approximately 20.5% of F-Squared Investment Management, LLC, of which F-Squared is a wholly-owned subsidiary. On December 22, 2014, the Commission filed a complaint against Present in the United States District Court for the District of Massachusetts.

## Facts

### Virtus Hired F-Squared to Subadvise Its Investment Products

10. In early 2009, Virtus and F-Squared began discussions to have F-Squared subadvise two Virtus-advised mutual funds, which would follow the AlphaSector sector rotation strategy. F-Squared marketed AlphaSector to Virtus as an ETF sector rotation strategy that was based on an algorithm that yields a “signal” indicating whether to buy or sell nine industry ETFs.<sup>2</sup> If the algorithm produced buy signals for three or fewer sector ETFs, the AlphaSector strategy provided for some or all of the assets to be invested in cash equivalents.

11. Present and F-Squared described the strategy falsely to Virtus by, among other things, representing that: (a) the AlphaSector strategy had been used to manage client assets from April 2001 to September 2008, often calling it a “live” track record; and (b) the track record had significantly outperformed the S&P 500 Index from April 2001 to September 2008. In reality, no assets tracked the strategy until 2008 and the back-tested track record was substantially overstated.

12. Virtus was negligent in not knowing that the F-Squared track record and performance were false. At the outset of the potential relationship with F-Squared, Virtus expressed skepticism about AlphaSector’s so-called “live” track record. Nevertheless, Virtus took no steps to determine whether F-Squared’s buy or sell signals were generated or used in any trading decisions during the April 2001 through September 2008 period.

13. Rather, Virtus recommended that the boards of trustees of the Virtus mutual funds and those funds’ shareholders approve the change in management and strategy to F-Squared and AlphaSector, respectively, based, at least in part, on the false historical performance of AlphaSector. Virtus presented materials to one fund board of trustees that stated: “The strategy has a model portfolio track record utilizing the actual signals of the quantitative model dating back 2001.” In correspondence to a different board of trustees, Virtus represented falsely that the “Premium AlphaSector strategy has a track record that started in 2001.” In documents provided to investors and included in certain funds’ 2009 proxy filed with the Commission, it was also falsely stated that F-Squared had “managed investments using the [AlphaSector] strategy since 2001.” Following Virtus’s advice and recommendation, the boards of trustees and shareholders eventually approved the transition of the mutual funds to AlphaSector.

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<sup>2</sup> F-Squared has created several AlphaSector strategies and sub-licenses approximately 75 AlphaSector indexes. The AlphaSector indexes that are the subject of this matter, including the AlphaSector Premium Index and the AlphaSector Rotation Index, are based on investments in U.S. Equity ETFs. As with all indexes, the performance of the AlphaSector Premium and AlphaSector Rotation indexes are inherently hypothetical in the sense that the index does not purport to reflect the performance of any particular client or account. However, the AlphaSector Premium Index and AlphaSector Rotation Index were advertised as being based on a strategy that had been in place since 2001 and therefore the performance of these indexes was advertised as “not backtested” when in fact the performance was backtested.

**Virtus's Marketing Efforts Contained Misleading Statements**

14. From 2009 through September 2013, Virtus used the claimed “live” eight-year track record of AlphaSector as a lead marketing point for Virtus’s AlphaSector products despite warnings in 2009 from a regulator that the track record in marketing materials was back-tested.

15. On October 1, 2009, the Financial Industry Regulatory Authority (“FINRA”) raised issues with Virtus about the track record of the AlphaSector Rotation Index after Virtus included it in mutual fund marketing materials. FINRA informed Virtus that “[b]ack-tested performance is misleading.” On November 24, 2009, FINRA notified Virtus that the “performance prior to October 13, 2008, when NASDAQ OMX began publishing and disseminating the [AlphaSector Rotation Index] value on a daily basis, is back-tested. We are concerned that the process could be manipulated to obtain desired outcomes.” Virtus nonetheless included the misleading “returns” of the back-tested AlphaSector index in appendices to certain Virtus AlphaSector Funds’ prospectuses and marketing materials, including detailing the purported performance on a year-by-year basis in the following manner.

The tables below show performance of the AlphaSector Rotation Index as compared with the performance of the S&P 500 Index. The AlphaSector Rotation Index and the S&P 500 Index are not available for direct investment and their performance does not reflect the fees, expenses or taxes associated with the active management of an actual portfolio. Both indexes are calculated on a total return basis with dividends reinvested.

Annual Returns (calendar year)	AlphaSector	S&P 500
	Rotation Index	Index
2002	-8.18%	-22.10%
2003	9.38%	28.68%
2004	13.89%	10.88%
2005	5.65%	4.91%
2006	14.40%	15.79%
2007	14.18%	5.49%
2008	-8.54%	-37.00%
2009	25.37%	26.46%
2010	15.50%	15.06%

Average Annual Total Return (for the periods ended 12/31/10)	Since Inception of AlphaSector Rotation Index (4/1/01) <sup>(1)</sup>	
	1 Year	5 Years
AlphaSector Rotation Index	15.50%	11.58%
S&P 500® Index	15.06%	2.29%

<sup>(1)</sup> The index inception date is April 1, 2001; it commenced daily calculation and dissemination by NASDAQ OMX with a base value 1,000.00 on October 13, 2008.

Virtus caused the funds to amend their prospectuses to include this past performance. Virtus also published and distributed marketing materials for separately managed accounts that included the misleading returns of the back-tested AlphaSector indexes. In addition, Virtus circulated this past performance through other means. For example, Virtus wholesalers emailed financial advisors links to presentations contained on the F-Squared website and directed them to the specific pages that contained the performance of the AlphaSector indexes for periods that included 2001-2008.

16. Certain Virtus wholesalers—who were the public face of the Virtus AlphaSector products—marketed the AlphaSector track record, which they characterized inaccurately. Virtus

wholesalers' talking points stated that "[AlphaSector] Index returns are not back tested as the track record is based on the actual model signals at the time they occurred since 2001" and falsely characterized the index as "live" or "running live assets."

17. Certain Virtus wholesalers also represented that a private wealth advisor had employed the strategy to invest real assets over the same securities and time period represented in the index—essentially, the index was a proxy for the track record of accounts that followed AlphaSector.

18. Virtus did not take adequate steps to correct the misstatements of its sales force and wholesalers even though some within Virtus had contradictory understandings of how to describe accurately the historical performance of AlphaSector. For example, Virtus's Product Management group understood that the AlphaSector Premium and AlphaSector Rotation indexes had no assets and never traded. The Virtus product manager responsible for AlphaSector also believed that the algorithm that drove the price momentum model underlying the AlphaSector strategy had been used since 2001, but on a different portfolio construction, including possibly different securities and trading rules. This product manager understood the AlphaSector strategy's then-current portfolio construction was not established by Present until 2008, meaning that no "live" assets could have been traded using the AlphaSector strategy prior to 2008 using the portfolio construction employed by the Virtus AlphaSector Funds. Virtus did not adequately communicate this understanding to Virtus's wholesalers.

#### **Virtus Failed to Respond to Concerns about AlphaSector and F-Squared**

19. While F-Squared and Present lied to Virtus about the history and performance of AlphaSector, Virtus did not adequately investigate concerns about the representations Present and F-Squared had made. For example, beginning in 2011, market participants told certain Virtus wholesalers that the AlphaSector indexes were backtested and "live" assets had not been tracking these indexes since 2001. When Virtus questioned Present about this, Present did not provide answers to many of the questions, but Virtus did not follow up to obtain the requested information or change how it used and marketed AlphaSector.

20. Virtus also received conflicting representations from Present about the origins of the strategy, including who created the strategy. Virtus asked Present to address these issues, but Present never answered them and Virtus did not otherwise follow up to obtain answers.

**Virtus Failed to Respond to Allegations Concerning  
The Accuracy of The AlphaSector Index Track Record**

21. In May 2013, principals for the firm that provided F-Squared with the signals for AlphaSector (the "Data Provider") informed Virtus that they believed the AlphaSector index's track record may have been miscalculated. The Data Provider's principals informed Virtus that it had attempted to recreate the advertised track record covering the 2001 through 2008 period, but could not. Virtus took no steps to follow up on the concerns raised by the Data Provider's principals.

**Virtus Failed to Adopt and Implement Adequate Policies and Procedures**

22. Virtus was required to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules. As an adviser that often relied on subadviser or other third-party-produced performance information or third-party marketing materials both in hiring or retaining subadvisers and in marketing a subadviser to its own clients or prospective clients, Virtus should have adopted and implemented policies and procedures reasonably designed to address the accuracy of such information and materials. However, Virtus had no written policies and procedures for evaluating and monitoring the accuracy of third-party-produced performance information or third-party marketing materials that Virtus directly or indirectly circulated or distributed to other persons. As a result, Virtus failed to adopt and implement reasonably designed written policies and procedures regarding the retention of books and records necessary to support the basis for performance information in advertisements directly or indirectly circulated or distributed by Virtus.

**Virtus Failed to Maintain Adequate Books and Records**

23. Virtus was required to make and keep true, accurate and current records or documents necessary to form the basis for or demonstrate the calculation of the performance or rate of returns that it circulated or distributed to 10 or more persons. Virtus circulated and distributed the 2001-2008 historical performance of AlphaSector indexes in client presentations, marketing materials, filings with the Commission, and other communications to numerous clients, investors, and potential investors. However, Virtus never made or kept sufficient records or documents to form the basis or demonstrate the calculation of the performance or rate of returns of the historical performance of the AlphaSector indexes.

**Violations**

24. As a result of the conduct described above, Respondent willfully<sup>3</sup> violated Section 206(2) of the Advisers Act, which prohibits any investment adviser from engaging in any

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<sup>3</sup> A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C.

transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. A violation of Section 206(2) may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id*

25. As a result of the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder, which prohibit any registered investment adviser from, directly or indirectly, publishing, circulating, or distributing an advertisement which contains any untrue statement of material fact, or which is otherwise false or misleading. A violation of Section 206(4) and the rules thereunder does not require scienter. *Steadman*, 967 F.2d at 647.

26. As a result of the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder by failing to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules.

27. As a result of the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which make it unlawful for any investment adviser to a pooled vehicle to make any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle, or to otherwise engage in any act, practice, or course of business that is fraudulent, deceptive or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.

28. As a result of the conduct described above, Respondent willfully violated Section 204 of the Advisers Act and Rule 204-2(a)(16) thereunder. Section 204 of the Advisers Act requires investment advisers to make and keep certain records as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. Rule 204-2 under the Advisers Act requires investment advisers registered or required to be registered to make and keep true, accurate and current various books and records relating to their investment advisory business, including all accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons.

29. As a result of the conduct described above, Respondent caused certain investment companies to violate Section 34(b) of the Investment Company Act which, among other things, makes it unlawful for any person to make any untrue or misleading statement of material fact in any registration statement, application, report, account, record, or other document filed with the

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Cir. 1965)).

Commission under the Investment Company Act, or to omit from any such document any fact necessary in order to prevent the statements made therein from being materially misleading.

### **Retention of a Compliance Consultant**

30. In determining to accept Respondent's Offer, the Commission considered Virtus's retention of an Independent Compliance Consultant in April 2015. Among other things, Virtus hired an Independent Compliance Consultant to conduct a comprehensive review of Virtus's written compliance policies and procedures addressing: (i) with respect to separately managed accounts, the publication, circulation, communication, or distribution of third-party marketing materials or materials that include third-party-produced performance information, (ii) with respect to mutual funds, the publication, circulation, communication, or distribution of third-party materials or materials (including marketing materials, proxy statements, prospectuses, statements of additional information) that include third-party-produced performance information, and (iii) with respect to the initial and continuing due diligence into and retention of subadvisers, policies and procedures related to appropriate oversight of subadviser compliance with Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder and Rule 38a-1 under the Investment Company Act, as appropriate.

### **IV.**

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Sections 204, 206(2), and 206(4) of the Advisers Act and Rules 204-2, 206(4)-1, 206(4)-7, and 206(4)-8 thereunder and Section 34(b) of the Investment Company Act.

B. Virtus is censured.

C. Virtus shall, within 10 days of the entry of this Order, pay disgorgement of \$13.4 million (\$13,400,000.00) and prejudgment interest of \$1.1 million (\$1,100,000.00) to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

- (1) Virtus may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Virtus may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

- (3) Virtus may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Virtus as the Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Jeffrey B. Finnell, Assistant Director, Asset Management Unit, Securities and Exchange Commission, 100 F Street N.E., Washington, DC 20549.

D. Virtus shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$2 million (\$2,000,000.00) to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

- (1) Virtus may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Virtus may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Virtus may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Virtus as the Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Jeffrey B. Finnell, Assistant Director, Asset Management Unit, Securities and Exchange Commission, 100 F Street N.E., Washington, DC 20549.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To

preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By **Jill M. Peterson**  
Assistant Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 4268 / November 17, 2015

ADMINISTRATIVE PROCEEDING  
File No. 3-16963

In the Matter of

FCG ADVISORS, LLC,

Respondent.

**ORDER INSTITUTING CEASE-AND-DESIST  
PROCEEDINGS PURSUANT TO SECTION  
203(k) OF THE INVESTMENT ADVISERS  
ACT OF 1940, MAKING FINDINGS, AND  
IMPOSING A CEASE-AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against FCG Advisors, LLC (“FCG Advisors” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

**III.**

On the basis of this Order and Respondent’s Offer, the Commission finds<sup>1</sup> that:

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<sup>1</sup> The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

## SUMMARY

1. These proceedings arise out of Respondent's act of permitting, without the consent of the Commission, Thomas A. Kolbe ("Kolbe") to associate with it from October 2008 through March 2010. At the time of such association, Kolbe was subject to an order entered by the Commission on August 30, 2004 in *In the Matter of Thomas A. Kolbe*, Advisers Act Release No. 2288 (the "Commission Order"), that barred him from, among other things, association with any investment adviser with a right to reapply for association after one (1) year from the date of the Commission Order.

## RESPONDENT

2. **FCG Advisors, LLC**, is a limited liability company organized under the laws of the State of New Jersey that is currently registered with the Commission solely as a broker dealer.<sup>2</sup> During the relevant time period of October 25, 2008 through March 19, 2010, FCG Advisors was registered with the Commission as both a broker dealer and an investment adviser, and held out Kolbe as a registered representative of the firm.

## BACKGROUND

3. From October 2001 through June 2003, Kolbe served as a Senior Vice President and the National Sales Manager for Invesco Funds Group, Inc. ("IFG"), a registered investment adviser to the Invesco mutual fund complex ("Funds").

4. On August 30, 2004, the Commission entered the Commission Order against Kolbe for his role in assisting IFG in negotiating and approving certain market timing agreements with select investors ("Market Timers").<sup>3</sup> The Commission found that Kolbe permitted the head of IFG's "market timing desk" to negotiate market timing agreements, which required Market Timers to keep their assets within the Funds in exchange for IFG allowing the Market Timers to engage in frequent trading.

5. The Commission found that, through his actions, Kolbe willfully aided and abetted and caused IFG's violations of Sections 206(1) and 206(2) of the Investment Advisers Act.

6. The Commission Order, among other things, (i) barred Kolbe from associating with any investment adviser with a right to reapply for association after one (1) year; (ii) prohibited

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<sup>2</sup> Respondent established a stand-alone registered investment adviser on or about March 28, 2013. That affiliated entity continues to be registered with the Commission as an investment adviser today.

<sup>3</sup> As explained in the Commission Order, "Market timing includes (a) frequent buying and selling of shares of the same mutual fund or (b) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing, while not illegal *per se*, can harm other mutual fund shareholders because it can dilute the value of their shares, if the market timer is exploiting pricing inefficiencies, or disrupt the management of the mutual fund's investment portfolio and can cause the targeted mutual fund to incur costs borne by other shareholders to accommodate frequent buying and selling of shares by the market timer."

Respondent from serving as a chairman, director, or officer of any investment adviser or as an officer or director of any registered investment company for two (2) years; (iii) imposed a \$150,000 civil penalty against Respondent; and (iv) ordered Respondent to pay disgorgement of one dollar (\$1).<sup>4</sup>

7. Section 203(f) of the Advisers Act states that “it shall be unlawful for any investment adviser to permit [any person as to whom such an order suspending or barring him from being associated with an investment adviser is in effect] to become, or remain, a person associated with [such investment adviser] without the consent of the Commission, if such investment adviser knew, or in the exercise of reasonable care, should have known, of such order.”

## FACTS

8. In October 2008, Kolbe applied to join Respondent as a registered representative. In connection therewith, Respondent executed a “Confidentiality and Non-Competition Agreement” on October 10, 2008 which was “effective as of the date of employment.” Respondent also completed a “pre-hire” disclosure and release on October 17, 2008, and agreed on October 25, 2008 to comply with FCG Advisors’ compliance policies and procedures.<sup>5</sup>

9. On or about October 25, 2008, Kolbe began working for Respondent as a registered representative of the firm.

10. Kolbe disclosed the Commission Order to Respondent prior to joining the firm.

11. Effective March 19, 2010, Respondent and Kolbe terminated their relationship.

12. Based on Kolbe’s relationship with Respondent, an investment adviser, Kolbe was a “person associated with an investment adviser,” as that term is defined in Section 202(a)(17) of the Advisers Act.<sup>6</sup>

13. Kolbe did not reapply with the Commission to associate with Respondent pursuant to Rule 193 of the Commission’s Rules of Practice (“Rule 193”),<sup>7</sup> nor did Respondent obtain the consent of the Commission to permit Kolbe to associate with it.

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<sup>4</sup> Kolbe paid the civil penalty and disgorgement in full.

<sup>5</sup> Many of the documents that Kolbe signed in October 2008 were addressed from Respondent to its “Registered Representatives and Associated Persons.”

<sup>6</sup> Section 202(a)(17) of the Advisers Act defines the term “person associated with an investment adviser” to mean “any partner, officer, or director of such investment adviser (or any person performing similar functions), or any person directly or indirectly controlling or controlled by such investment adviser, including any employee of such investment adviser, except that for the purposes of section 203 of this title (other than subsection (f) thereof), persons associated with an investment adviser whose functions are clerical or ministerial shall not be included in the meaning of such term.”

## VIOLATION

14. As a result of the above-described conduct, Respondent violated Section 203(f) of the Advisers Act, which prohibits any investment adviser from permitting any person as to whom an order suspending or barring him or her from being associated with an investment adviser is in effect to become, or remain, a person associated with it without the consent of the Commission, if such investment adviser knew, or in the exercise of reasonable care, should have known, of such order.

### IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that pursuant to Section 203(k) of the Advisers Act, Respondent FCG Advisors cease and desist from committing or causing any violations and any future violations of Section 203(f) of the Advisers Act.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
Assistant Secretary

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<sup>7</sup> The Commission Order directed Kolbe to reapply for association "to the appropriate self-regulatory organization, or if there is none, to the Commission." Because there was and is no self-regulatory organization responsible for processing applications to associate with investment advisers, such applications must be made directly to the Commission pursuant to Rule 193, which governs applications for Commission consent to associate with, among other entities, an investment adviser, where a Commission order bars an individual from such association and contains a proviso that application may be made to the Commission after a specified period of time.

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4269 / November 17, 2015**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 31903 / November 17, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16964**

**In the Matter of**

**THOMAS A. KOLBE**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTIONS 203(f) AND 203(k)  
OF THE INVESTMENT ADVISERS ACT OF  
1940 AND SECTION 9(b) OF THE  
INVESTMENT COMPANY ACT OF 1940  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Thomas A. Kolbe ("Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### SUMMARY

1. These proceedings arise out of Respondent's violation of a Commission order entered on August 30, 2004 in *In the Matter of Thomas A. Kolbe*, Advisers Act Release No. 2288 (the "Commission Order"), which, among other things, barred Respondent from association with any investment adviser with a right to reapply for association after one (1) year from the date of the Commission Order. Respondent violated the Commission Order by associating, without reapplying to the Commission for association, with three different investment advisers at various time between 2006 and 2013.

#### RESPONDENT

2. **Thomas A. Kolbe**, age 66, is a resident of Centennial, Colorado. From approximately January 5, 2006 through November 15, 2006, Respondent was a registered representative of a broker dealer and an investment adviser ("Advisory Firm A").<sup>2</sup> Similarly, from approximately October 25, 2008 through March 19, 2010, Respondent was a registered representative of a broker dealer and an investment adviser, FCG Advisors, LLC ("Advisory Firm B").<sup>3</sup> Finally, from approximately July 1, 2012 through February 22, 2013, Respondent was an employee of an investment adviser ("Advisory Firm C").<sup>4</sup> Respondent received compensation from Advisory Firm A, Advisory Firm B, and Advisory Firm C.

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

<sup>2</sup> Advisory Firm A ceased doing business in the securities industry in 2009. It filed Form ADV-W with the Commission on December 8, 2008, and Form BD-W with the Commission on December 18, 2009.

<sup>3</sup> Advisory Firm B established a stand-alone registered investment adviser on or about March 28, 2013. That affiliated entity continues to be registered with the Commission as an investment adviser today.

<sup>4</sup> Advisory Firm C has ceased operations, is no longer in good standing in either the State of Delaware, where it was organized, or the State of New York, where it was registered as a foreign limited liability company, withdrew its registration from the Commission on March 31, 2014, and has not done business in the securities industry since March 31, 2014.

## BACKGROUND

3. From October 2001 through June 2003, Respondent served as a Senior Vice President and the National Sales Manager for Invesco Funds Group, Inc. ("IFG"), a registered investment adviser to the Invesco mutual fund complex ("Funds").

4. On August 30, 2004, the Commission entered the Commission Order against Respondent for his role in assisting IFG in negotiating and approving certain market timing agreements with select investors ("Market Timers").<sup>5</sup> The Commission found that Respondent permitted the head of IFG's "market timing desk" to negotiate market timing agreements, which required Market Timers to keep their assets within the Funds in exchange for IFG allowing the Market Timers to engage in frequent trading.

5. The Commission found that, through his actions, Respondent willfully aided and abetted and caused IFG's violations of Sections 206(1) and 206(2) of the Investment Advisers Act.

6. The Commission Order, among other things, (i) barred Respondent from associating with any investment adviser with a right to reapply for association after one (1) year; (ii) prohibited Respondent from serving as a chairman, director, or officer of any investment adviser or as an officer or director of any registered investment company for two (2) years; (iii) imposed a \$150,000 civil penalty against Respondent; and (iv) ordered Respondent to pay disgorgement of one dollar (\$1).<sup>6</sup>

## FACTS

7. On or about January 5, 2006, Respondent began working as a registered representative of Advisory Firm A.

8. Effective November 15, 2006, Advisory Firm A and Respondent terminated their relationship.

9. On or about October 25, 2008, Respondent began working as a registered representative of Advisory Firm B.

10. Effective March 19, 2010, Advisory Firm B and Respondent terminated their relationship.

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<sup>5</sup> As explained in the Commission Order, "Market timing includes (a) frequent buying and selling of shares of the same mutual fund or (b) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing, while not illegal *per se*, can harm other mutual fund shareholders because it can dilute the value of their shares, if the market timer is exploiting pricing inefficiencies, or disrupt the management of the mutual fund's investment portfolio and can cause the targeted mutual fund to incur costs borne by other shareholders to accommodate frequent buying and selling of shares by the market timer."

<sup>6</sup> Respondent paid the civil penalty and disgorgement in full.

11. On or about July 1, 2012, Respondent began working for Advisory Firm C as its Senior Vice President and Director of Sales. On or about November 16, 2012, Respondent changed positions at Advisory Firm C, and became its Director of Retirement Plan Sales.

12. Effective February 22, 2013, Advisory Firm C and Respondent terminated their relationship.

13. Respondent was a "person associated with an investment adviser," as that term is defined in Section 202(a)(17) of the Advisers Act,<sup>7</sup> with respect to Advisory Firm A, Advisory Firm B, and Advisory Firm C based upon his relationship with each of these investment advisers.

14. Respondent disclosed the Commission Order to Advisory Firm A, Advisory Firm B, and Advisory Firm C prior to joining each of these firms.

15. In contravention of the Commission Order, Respondent did not reapply with the Commission to associate with Advisory Firm A, Advisory Firm B, or Advisory Firm C pursuant to Rule 193 of the Commission's Rules of Practice ("Rule 193"),<sup>8</sup> nor did he otherwise obtain the consent of the Commission to associate with Advisory Firm A, Advisory Firm B, or Advisory Firm C.

#### VIOLATION

16. As a result of the above-described conduct, Respondent willfully<sup>9</sup> violated Section 203(f) of the Advisers Act, which prohibits anyone who has been barred from being associated with an investment adviser willfully to become associated with an investment adviser without the consent of the Commission.

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<sup>7</sup> Section 202(a)(17) of the Advisers Act defines the term "person associated with an investment adviser" to mean "any partner, officer, or director of such investment adviser (or any person performing similar functions), or any person directly or indirectly controlling or controlled by such investment adviser, including any employee of such investment adviser, except that for the purposes of section 203 of this title (other than subsection (f) thereof), persons associated with an investment adviser whose functions are clerical or ministerial shall not be included in the meaning of such term."

<sup>8</sup> The Commission Order directed Respondent to reapply for association "to the appropriate self-regulatory organization, or if there is none, to the Commission." Because there was and is no self-regulatory organization responsible for processing applications to associate with investment advisers, such applications must be made directly to the Commission pursuant to Rule 193, which governs applications for Commission consent to associate with, among other entities, an investment adviser, where a Commission order bars an individual from such association and contains a proviso that application may be made to the Commission after a specified period of time.

<sup>9</sup> A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).



#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Kolbe's Offer.

Accordingly, pursuant to Sections 203(f) and 203(k) of the Advisers Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Kolbe cease and desist from committing or causing any violations and any future violations of Section 203(f) of the Advisers Act.

B. Respondent Kolbe be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter;

with the right to apply for reentry after one (1) year to the appropriate self-regulatory organization, or if there is none, to the Commission.

C. Any reapplication for association by Respondent Kolbe will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent Kolbe shall pay disgorgement of \$25,000 and civil penalties of \$25,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). Payment shall be made in the following installments: (i) \$12,500 within fifteen (15) days of the entry of this Order; (ii) \$12,500 within one-hundred-eighty (180) days of the entry of this Order; (iii) \$12,500 within two-hundred-seventy (270) days of the entry of this Order; and (iv) \$12,500 within three-hundred-sixty-five (365) days of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement and civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. § 3717 and SEC Rule of Practice 600, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Respondent Kolbe as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Paul Montoya, Assistant Director, Division of Enforcement, Securities and Exchange Commission, Chicago Regional Office, 175 West Jackson Boulevard, Suite 900, Chicago, IL 60604-2908.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

#### V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by

Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. § 523(a)(19).

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
Assistant Secretary

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Parts 240, 242, 249**

**Release No. 34-76474; File No. S7-23-15**

**RIN 3235-AL66**

**Regulation of NMS Stock Alternative Trading Systems**

**AGENCY:** Securities and Exchange Commission

**ACTION:** Proposed rule

**SUMMARY:** The Securities and Exchange Commission is proposing to amend the regulatory requirements in Regulation ATS under the Securities Exchange Act of 1934 ("Exchange Act") applicable to alternative trading systems ("ATs") that transact in National Market System ("NMS") stocks (hereinafter referred to as ("NMS Stock ATs")), including so called "dark pools." First, the Commission is proposing to amend Regulation ATS to adopt Form ATS-N.

Proposed Form ATS-N would require NMS Stock ATs to provide information about the broker-dealer that operates the NMS Stock ATs ("broker-dealer operator") and the activities of the broker-dealer operator and its affiliates in connection with the NMS Stock ATs, including: their operation of non-ATS trading centers and other NMS Stock ATs; products and services offered to subscribers; arrangements with unaffiliated trading centers; trading activities on the NMS Stock ATs; smart order router (or similar functionality) and algorithms used to send or receive orders or other trading interest to or from the ATs; personnel and third parties used to operate the NMS Stock ATs; differences in the availability of services, functionalities, or procedures; and safeguards and procedures to protect subscribers' confidential trading information. Proposed Form ATS-N would also require NMS Stock ATs to provide detailed information about the manner of operations of the ATs, including: types of subscribers; hours of

operation; types of orders; connectivity, order entry, and co-location procedures; segmentation of order flow and notice about segmentation; display of order and other trading interest; trading services, including matching methodologies, order interaction rules, and order handling and execution procedures; procedures governing suspension of trading or trading during system disruption or malfunction; opening, reopening, closing, and after hours procedures; outbound routing services; fees; market data; trade reporting; clearance and settlement; order display and execution access (if applicable); fair access (if applicable); and market quality statistics published or provided to one or more subscribers. Second, the Commission is proposing to make filings on Form ATS-N public by posting certain Form ATS-N filings on the Commission's internet website and requiring each NMS Stock ATS that has a website to post on the NMS Stock ATS's website a direct URL hyperlink to the Commission's website that contains the documents enumerated in proposed Rule 304(b)(2). Third, the Commission is proposing to amend Regulation ATS to adopt new Rule 304, which would provide a process for the Commission to determine whether an entity qualifies for the exemption from the definition of "exchange" pursuant to Exchange Act Rule 3a1-1(a)(2) with regard to NMS stocks and declare an NMS Stock ATS's Form ATS-N either effective or, after notice and opportunity for hearing, ineffective. Fourth, under the proposal, the Commission could suspend, limit, or revoke the exemption provided under Rule 3a1-1(a)(2) after providing notice and opportunity for hearing. Fifth, the Commission is proposing to amend Exchange Act Rule 301(b)(10) of Regulation ATS to require that an ATS's safeguards and procedures to protect subscribers' confidential trading information be written. The Commission is also proposing to make conforming changes to Regulation ATS and Exchange Act Rule 3a1-1(a). Additionally, the Commission is requesting comment about, among other things, changing the requirements of the exemption provided under

Exchange Act Rule 3a1-1(a) for ATs that facilitate transactions in securities other than NMS stocks. Lastly, the Commission is also requesting comment regarding its consideration to amend Exchange Act Rules 600 and 606 to improve transparency around the handling and routing of institutional customer orders by broker-dealers.

**DATES:** Comments should be received on or before [insert date 60 days after publication in the Federal Register].

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-23-15 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-23-15. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/proposed.shtml>). Comments will also be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not

edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at [www.sec.gov](http://www.sec.gov) to receive notifications by e-mail.

**FOR FURTHER INFORMATION CONTACT:** Tyler Raimo, Senior Special Counsel, at (202) 551-6227; Matthew Cursio, Special Counsel, at (202) 551-5748; Marsha Dixon, Special Counsel, at (202) 551-5782; Jennifer Dodd, Special Counsel, at (202) 551-5653; David Garcia, Special Counsel, at (202) 551-5681; or Derek James, Special Counsel, at (202) 551-5792; Office of Market Supervision, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

**SUPPLEMENTARY INFORMATION:**

The Commission is proposing: (1) new Form ATS-N under the Exchange Act provided by Rule 3a1-1(a) of the Exchange Act [17 CFR 240.3a1-1(a)], which NMS Stock ATSS would rely on to qualify for the exemption from the definition of "exchange"; (2) to amend Regulation ATS under the Exchange Act [17 CFR 242.300-303] to add new Rule 304 to provide new conditions for NMS Stock ATSS seeking to rely on the exemption from the definition of "exchange"; and (3) related amendments to Rule 300, 301, and 303 of Regulation ATS and Rule 3a1-1(a) under the Exchange Act [17 CFR 242.300; 17 CFR 242.301, 17 CFR 242.303; and 17 CFR 240.3a1-1]. The Commission is also proposing amendments to Rules 301(b)(10) and 303 of Regulation ATS under the Exchange Act [17 CFR 242.301(b)(10) and 17 CFR 242.303] to

require all ATSS to make and keep written safeguards and written procedures to protect subscribers' confidential trading information.

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## I. Introduction

Section 11A(a)(2) of the Exchange Act,<sup>1</sup> enacted as part of the Securities Acts Amendments of 1975 (“1975 Amendments”),<sup>2</sup> directs the Commission, having due regard for the public interest, the protection of investors, and the maintenance of fair and orderly markets, to use its authority under the Exchange Act to facilitate the establishment of a national market system for securities in accordance with the Congressional findings and objectives set forth in Section 11A(a)(1) of the Exchange Act.<sup>3</sup> Among the findings and objectives in Section 11A(a)(1) are that “[n]ew data processing and communications techniques create the opportunity for more efficient and effective market operations”<sup>4</sup> and “[i]t is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure . . . the economically efficient execution of securities transactions”<sup>5</sup> and the “practicability of brokers executing investors’ orders in the best markets.”<sup>6</sup> Congress also found, as noted by the Commission when it adopted Regulation ATS, that it was in the public interest to assure “fair competition . . . between exchange markets and markets other than exchange markets.”<sup>7</sup>

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<sup>1</sup> 15 U.S.C. 78k-1(a)(2).

<sup>2</sup> Pub. L. 94-29, 89 Stat. 97 (1975).

<sup>3</sup> 15 U.S.C. 78k-1(a)(1).

<sup>4</sup> Section 11A(a)(1)(B) of the Exchange Act, 15 U.S.C. 78k-1(a)(1)(B).

<sup>5</sup> Section 11A(a)(1)(C)(i) of the Exchange Act, 15 U.S.C. 78k-1(a)(1)(C)(i).

<sup>6</sup> Section 11A(a)(1)(C)(iv) of the Exchange Act, 15 U.S.C. 78k-1(a)(1)(C)(iv).

<sup>7</sup> See Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) (Regulation of Exchanges and Alternative Trading Systems, hereinafter “Regulation ATS Adopting Release”) at 70858 n.113 and accompanying text (citing Section 11A(a)(1)(C)(ii) of the Exchange Act, 15 U.S.C. 78k-1(a)(1)(C)(ii)). The Commission also noted that a fundamental goal of a national market system was to “achieve a market characterized by economically efficient executions, fair competition,

Congress recognized that the securities markets dynamically change and, accordingly, granted the Commission broad authority to oversee the implementation, operation, and regulation of the national market system in accordance with Congressional goals and objectives.<sup>8</sup>

In December 1998, the Commission adopted Regulation ATS to advance the goals of the national market system and establish a regulatory framework for ATSS.<sup>9</sup> At that time, there had been a surge in a variety of alternative trading systems that traded NMS stocks and furnished services traditionally provided by national securities exchanges,<sup>10</sup> such as matching counterparties' orders, executing trades, operating limit order books, and facilitating active price discovery.<sup>11</sup> The Commission observed at the time that, among other things, activity on ATSS was not fully disclosed, or accessible, to investors, and that these systems had no obligation to provide investors a fair opportunity to participate on the systems or to treat their participants fairly.<sup>12</sup> The Commission noted in the Regulation ATS Adopting Release that while ATSS at that time operated in a manner similar to registered national securities exchanges, each type of trading center was subject to different regulatory regimes, and that these differences created

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[and the] broad dissemination of basic market information.” See id. at 70858 n.113 (quoting S. Rep. No. 75, 94th Cong., 1st Sess. 8 (1975) at 101).

<sup>8</sup> See id. at 70858 n.110 and accompanying text (citing S. Rep. No. 75, 94th Cong., 1st Sess. 8 (1975) at 8-9). The Commission also noted that Congress explicitly rejected mandating specific components of a national market system because of uncertainty as to how technological and economic changes would affect the securities market. See id. at 70858 n.109 and accompanying text (citing S. Rep. No. 75, 94th Cong., 1st Sess. 8 (1975) at 8-9).

<sup>9</sup> See generally Regulation ATS Adopting Release, supra note 7.

<sup>10</sup> See id. at 70845.

<sup>11</sup> See id. at 70848.

<sup>12</sup> See id. at 70845.

disparities that affected investor protection and the operation of the markets as a whole, calling into question the fairness of the then-current regulatory requirements.<sup>13</sup>

In response to the substantial changes in the way securities were traded at the time, and the regulatory disparity between registered national securities exchanges and non-exchange markets, the Commission adopted a new regulatory framework that the Commission believed would encourage market innovation, while ensuring basic investor protections,<sup>14</sup> by giving securities markets a choice to register as national securities exchanges, or to register as broker-dealers and comply with Regulation ATS. Regulation ATS was designed to permit market centers meeting the Commission's updated interpretation of the definition of "exchange," as set forth in Exchange Act Rule 3b-16,<sup>15</sup> to select the regulatory framework more applicable to their business models. Among other things, Regulation ATS was intended to better integrate ATSs into the national market system, and ensure that market participants have fair access to ATSs with significant volume.<sup>16</sup>

In the seventeen years since the Commission adopted Regulation ATS, the equity markets have evolved significantly, resulting in an increased number of trading centers and a

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<sup>13</sup> See *id.* at 70845-46 (noting that alternative trading systems prior to the adoption of Regulation ATS were private markets, which were open to only chosen subscribers, and were regulated as broker-dealers and not like registered national securities exchanges).

<sup>14</sup> See *id.* at 70847.

<sup>15</sup> 17 CFR 240.3b-16.

<sup>16</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70846, 70874. The Commission also notes that when it adopted Regulation ATS, it stated its belief that the Commission's regulation of markets should both accommodate traditional market structures and provide sufficient flexibility to ensure that new markets promote fairness, efficiency, and transparency. See Regulation ATS Adopting Release, *supra* note 7, at 70846.

reduced concentration of trading activity in NMS stocks.<sup>17</sup> The growth in trading centers and trading activity has been fueled primarily by advances in technology for generating, routing, and executing orders. These technologies have markedly improved the speed, capacity, and sophistication of the trading mechanisms and processes that are available to market participants. Today, ATSS that trade NMS stocks have become an integral part of the national market system, as the number of these ATSS, and the volume of NMS stocks transacted on them, has increased significantly since the adoption of Regulation ATS.<sup>18</sup> Despite the emergence of ATSS as a significant source of liquidity in NMS stocks among today's markets, and the fact that ATSS compete with, and operate with almost the same complexity and sophistication as, registered national securities exchanges, the regulatory requirements applicable to ATSS have remained, for the most part, the same since Regulation ATS was adopted.<sup>19</sup>

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<sup>17</sup> See Securities Exchange Act Release No. 73639 (November 19, 2014), 79 FR 72251 (December 5, 2014), 72262 (adopting final rules for systems compliance and integrity) (“SCI Adopting Release”) at 72262 n.105 and n.106 and accompanying text (discussing the increased significance of NMS Stock ATSS).

<sup>18</sup> See *infra* notes 116-122 and accompanying text.

<sup>19</sup> The Commission notes that when the Commission adopted Regulation NMS, it also amended Regulation ATS to lower the threshold that triggers the Regulation ATS fair access requirements from 20% of the average daily volume in a security to 5%. See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37550 (June 29, 2005) (“Regulation NMS Adopting Release”). See also *infra* notes 92-95 and accompanying text (discussing the fair access requirements of Regulation ATS).

When adopting Regulation ATS, the Commission noted that the 20% volume threshold was based on current market conditions, and that if such conditions changed, or if the Commission believed that alternative trading systems with less than 20% of the trading volume were engaging in inappropriate exclusionary practices or in anticompetitive conduct, the Commission could revisit the fair access thresholds. See Regulation ATS Adopting Release, *supra* note 7, at 70873 n.245. The Commission also stated its intent to monitor the impact and effect of the fair access rules, as well as the practices of ATSS, and consider changing the rules if necessary to prevent anticompetitive behavior and

Although ATs and registered national securities exchanges generally operate in a similar manner and compete as trading centers for order flow in NMS stocks, each of these types of trading centers is subject to a separate regulatory regime with a different mix of benefits and obligations, including with respect to their obligations to disclose information about their trading operations. Unlike ATs, national securities exchanges must register with the Commission pursuant to Section 6 of the Exchange Act,<sup>20</sup> and undertake self-regulatory<sup>21</sup> obligations over their members. Before a national securities exchange may commence operations, the Commission must approve the national securities exchange's application for registration filed on Form 1. Section 6(b) of the Exchange Act requires, among other things, that the national securities exchange be so organized and have the capacity to carry out the purposes of the Exchange Act and to comply and enforce compliance by its members, and persons associated with its members, with the federal securities laws and the rules of the exchange.<sup>22</sup> Both a national securities exchange's registration application and the Commission's order approving the application are public. After registering, a national securities exchange must file with the

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ensure that qualified investors have access to significant sources of liquidity in the securities markets. See id.

See also infra note 107 and accompanying text (discussing amendments to Regulation ATs in connection with the adoption of Regulation SCI).

<sup>20</sup> 15 U.S.C. 78f.

<sup>21</sup> Section 3(a)(26) of the Exchange Act defines a self-regulatory organization ("SRO") as any national securities exchange, registered securities association, registered clearing agency, or (with limitations) the Municipal Securities Rulemaking Board. See 15 U.S.C. 78c(a)(26).

<sup>22</sup> See Section 6(b)(1) of the Exchange Act, 15 U.S.C. 78f(b)(1). The Commission must also find that the national securities exchange has rules that meet certain criteria. See generally Exchange Act Section 6(b)(2)-(10), 15 U.S.C. 78f(b)(2)-(10).

Commission any proposed changes to its rules.<sup>23</sup> The initial application on Form 1, amendments thereto, and filings for proposed rule changes, in combination, publicly disclose important information about national securities exchanges, such as trading services and fees. As an SRO, a national securities exchange enjoys certain unique benefits, such as limited immunity from private liability with respect to its regulatory functions and the ability to receive market data revenue, among others.

Although falling within the statutory definition of “exchange,” an ATS is exempt from that definition if it complies with Regulation ATS. Regulation ATS includes the requirement that, as an alternative to registering as a national securities exchange, an ATS must register as a broker-dealer with the Commission, which entails becoming a member of an SRO, such as the Financial Industry Regulatory Authority (“FINRA”).<sup>24</sup> Unlike national securities exchanges, ATSs are not approved by the Commission, but are instead required only to provide notice of their operations by filing a Form ATS with the Commission 20 days before commencing operations as an ATS.<sup>25</sup> Form ATS is “deemed confidential when filed,”<sup>26</sup> and it only requires an ATS to disclose limited aspects of the ATS’s operations. ATSs are neither required to file proposed rule changes with the Commission nor otherwise publicly disclose their trading services, operations, or fees.

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<sup>23</sup> See generally Section 19(b) of the Exchange Act, 15 U.S.C. 78s(b).

<sup>24</sup> Section 15(b)(8) of the Exchange Act requires a broker or dealer to become a member of a registered national securities association, unless it effects transactions in securities solely on an exchange of which it is a member. 15 U.S.C. 78o(b)(8).

<sup>25</sup> See Regulation ATS Adopting Release, supra note 7, at 70863 and infra Section II.B (discussing the current requirements of Regulation ATS applicable to all ATSs).

<sup>26</sup> See 17 CFR 242.301(b)(2)(vii).

The Commission is concerned that the current regulatory requirements relating to operational transparency for ATSS, particularly those that execute trades in NMS stocks, may no longer fully meet the goals of furthering the public interest and protecting investors. Today, ATSS account for approximately 15.4% of the total dollar volume in NMS stocks<sup>27</sup> and as noted, compete with, and operate with respect to trading in a manner similar to, registered national securities exchanges. Unlike registered national securities exchanges, however, there is limited public information available to market participants about the operations of ATSS, including how orders and other trading interest may interact, match, and execute on ATSS. The Commission is concerned that the differences between ATSS that trade NMS stocks and registered national securities exchanges with regard to operational transparency may be creating a competitive imbalance between two functionally similar trading centers that may trade the same security but are subject to different regulatory requirements. The Commission is also concerned that this difference in operational transparency disadvantages market participants by limiting their ability to adequately assess the relative merits of many trading centers.<sup>28</sup> Specifically, the Commission is concerned that the lack of operational transparency around ATSS limits market participants' ability to adequately discern how their orders interact, match, and execute on ATSS and to find the optimal market or markets for their orders.

The Commission is also concerned about the current lack of transparency around

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<sup>27</sup> See infra Table 1 "NMS Stock ATSS Ranked by Dollar Trading Volume – March 30, 2015 to June 26, 2015." Total dollar trading volume on all exchanges and off-exchange trading in the second quarter of 2015 was approximately \$16.3 trillion and approximately 397 billion shares. See id.

<sup>28</sup> Market participants may include many different types of persons seeking to transact in NMS stocks, including broker-dealers and institutional or retail investors.

potential conflicts of interest that arise from the activities of the broker-dealer operator of the NMS Stock ATS and its affiliates<sup>29</sup> in connection with the ATS. As discussed herein, an ATS must register as a broker-dealer pursuant to Rule 301(b)(1) of Regulation ATS. This broker-dealer operator, its affiliates, or both, however, may also conduct brokerage or dealing activities in NMS stocks in addition to operating the ATS.<sup>30</sup> Broker-dealer operators may also have affiliates that support the operations of the ATS or trade on it. The Commission notes that these multi-service broker-dealers that engage in brokerage and dealing activities, in addition to the operation of their ATSs, have become more prevalent since the adoption of Regulation ATS and the other services multi-service broker-dealers provide have become increasingly intertwined with the operation of their ATSs. Given the unique position that the broker-dealer operator and its affiliates occupy with regard to the operation of an ATS, potential conflicts of interest arise when the various business interests of the broker-dealer operator or its affiliates compete with the interests of market participants that access and trade on the ATS.<sup>31</sup> Some of the recent settled

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<sup>29</sup> The Commission is proposing to define “affiliate” for purposes of proposed Form ATS-N as described and discussed further below. See infra note 376 and accompanying text. See also Instruction G to proposed Form ATS-N.

<sup>30</sup> Throughout this release, broker-dealer operators of NMS Stock ATSs that also provide brokerage or dealing services in addition to operating an NMS Stock ATS are referred to as “multi-service broker-dealers”.

<sup>31</sup> See infra Section VII.A (discussing the relationship between NMS Stock ATSs and the other business functions of their broker-dealer operators). The Commission notes that, although it was concerned at the time of adoption of Regulation ATS about conflicts of interest that may be present when the broker-dealer operator of an ATS also performs other trading functions (see infra notes 526-528 and accompanying text discussing the Commission’s concerns regarding the potential for misuse of confidential trading information that led to the adoption of Rule 301(b)(10)), the business structure of broker-dealers that operate NMS Stock ATSs has changed since 1998.

actions against ATSS highlight this potential.<sup>32</sup> As discussed further below, although the operations of most ATSS and their broker-dealer operators have become more closely connected, market participants receive limited information about the activities of the broker-dealer operator and its affiliates and the potential conflicts of interest that arise from these activities.

Transparency is a hallmark of the U.S. securities markets and a primary tool by which investors protect their own interests, and the Commission is concerned that the current lack of transparency around potential conflicts of interest of the broker-dealer operator may impede market participants from adequately protecting their interests when doing business on the NMS Stock ATS. The Commission preliminarily believes that if market participants have more information about the operations of NMS Stock ATSS and the activities of the broker-dealer operators and the broker-dealer operators' affiliates, they could better evaluate whether to do business with an ATS and make more informed decisions about where to route their orders.<sup>33</sup>

The Commission has long recognized that effective competition requires transparency and access across the national market system.<sup>34</sup> The Commission preliminarily believes that the proposals discussed below could promote more efficient and effective market operations by

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<sup>32</sup> See infra note 373 and accompanying text.

<sup>33</sup> See, e.g., infra notes 187 and 189 and accompanying text (discussing a comment by the Consumer Federation of America about how more detailed information about ATS operations would allow participants to assess whether it makes sense to trade on that venue, and a comment by Bloomberg Tradebook LLC that because buy-side representatives might not be customers of all ATSS, they could not assess order interaction that occurs across the market structure); and infra note 372 (citing recent enforcement actions settled by the Commission, many of which, such as the Liquidnet Settlement, the Pipeline Settlement, the UBS Settlement, and the ITG Settlement, included allegations that subscribers were fraudulently misled about the operations of certain ATSS).

<sup>34</sup> See generally Regulation ATS Adopting Release, supra note 7.

providing more transparency to market participants about the operations of ATSS and the potential conflicts of interest of the controlling broker-dealer operator and its affiliates.<sup>35</sup> The Commission preliminarily believes that the operational transparency rules being proposed today could increase competition among trading centers in regard to order routing and execution quality. For example, the proposed rules could reveal order interaction procedures that may result in the differential treatment of some order types handled by an NMS Stock ATS. This improved visibility, in turn, could cause market participants to shift order flow to NMS Stock ATSS that provide better opportunities for executions. The Commission preliminarily believes that the proposal could facilitate comparisons among trading centers in NMS stocks and increase competition by informing market participants about the operations of NMS Stock ATSS.

The Commission preliminarily believes that a wide range of market participants would benefit from the operational transparency that would result from the proposal. For example, many brokers subscribe to NMS Stock ATSS and route their orders, and those of their customers, to NMS Stock ATSS for execution. The Commission preliminarily believes that improved transparency about the operations of NMS Stock ATSS could aid brokers with meeting their best execution obligations to their customers, as they can better assess the trading venues to which

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<sup>35</sup> See *infra* Sections XIII.B and C (analyzing the possible impact from the current lack of public disclosure of NMS Stock ATSS' operations, as well as disparate levels of information available to market participants about NMS Stock ATS operations and the activities of their broker-dealer operators and their affiliates; the competitive environment between national securities exchanges and NMS Stock ATSS, between NMS Stock ATSS, and between broker-dealers that operate NMS Stock ATSS and broker-dealers that do not operate NMS Stock ATSS; and the anticipated costs and benefits of improving transparency).

they route orders.<sup>36</sup> The duty of best execution requires broker-dealers to execute customers' trades at the most favorable terms reasonably available under the circumstances (i.e., at the best reasonably available price).<sup>37</sup> The Commission has not viewed the duty of best execution as inconsistent with the automated routing of orders or requiring automated routing on an order-by-order basis to the market with the best quoted price at the time.<sup>38</sup> Rather, the duty of best execution requires broker-dealers to periodically assess the quality of competing markets to

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<sup>36</sup> See, e.g., infra note 187 and accompanying text (noting that The Consumer Federation of America previously commented that Form ATS should require ATSs to provide "critical details about an ATS's participants, segmentation, and fee structure" because the "information will allow market participants, regulators, and third party analysts to assess whether an ATS's terms of access and service are such that it makes sense to trade on that venue").

<sup>37</sup> A broker-dealer's duty of best execution derives from common law agency principles and fiduciary obligations, and is incorporated in SRO rules and, through judicial and Commission decisions, in the antifraud provisions of the federal securities laws. See Order Execution Obligations, Securities Exchange Act Release No. 37619A (Sept. 6, 1996), 61 FR 48290, 48322 (Sept. 12, 1996). See also Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 135 F.3d 266, 270, 273 (3d Cir. 1998) (en banc), cert. denied, 525 U.S. 811 (1998) (finding that failure to satisfy the duty of best execution can constitute fraud because a broker-dealer, in agreeing to execute a customer's order, makes an implied representation that it will execute it in a manner that maximizes the customer's economic gain in the transaction, and stating that "[T]he basis for the duty of best execution is the mutual understanding that the client is engaging in the trade—and retaining the services of the broker as his agent—solely for the purpose of maximizing his own economic benefit, and that the broker receives her compensation because she assists the client in reaching that goal."); Matter of Marc N. Geman, Securities Exchange Act Release No. 43963 (Feb. 14, 2001), aff'd, Geman v. SEC, 334 F.3d 1183 (10th Cir. 2003) (citing Newton, but deciding against finding a violation of the duty of best execution based on the record). See also Payment for Order Flow, Securities Exchange Act Release No. 34902 (Oct. 27, 1994), 59 FR 55006, 55009 (Nov. 2, 1994). If the broker-dealer intends not to act in a manner that maximizes the customer's economic gain when he accepts the order and does not disclose this to the customer, a trier of fact could find that the broker-dealer's implied representation was false. See Newton, 135 F.3d at 273–274.

<sup>38</sup> See Regulation NMS Adopting Release, supra note 19, at 37538.

assure that order flow is directed to the markets providing the most beneficial terms for their customer orders.<sup>39</sup>

In addition, the Commission preliminarily believes that the proposal could also help customers of broker-dealers, whose orders are routed to an NMS Stock ATS for possible execution in the ATS, evaluate whether their broker-dealer fulfilled its duty of best-execution. The Commission preliminarily believes that institutional investors, who may subscribe to an NMS Stock ATS or whose orders may be routed to an NMS Stock ATS by their brokers, should have more information about how NMS Stock ATSs operate, including how the ATS may match and execute customer orders.<sup>40</sup> The Commission preliminarily believes that additional information about how NMS Stock ATSs operate could aid these investors in evaluating the routing decisions of their brokers and understanding whether their broker routed their orders to a

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<sup>39</sup> Id.

<sup>40</sup> See, e.g., Consumer Federation of America letter, infra note 175, at 22, 37-38 (expressing support for requiring all ATSs to publicly disclose Form ATS “so that the public can see how these venues operate,” and opining that the Commission should “undertake an exhaustive investigation of the current order types, requiring exchanges and all ATSs . . . to disclose in easily understandable terms what their purpose is, how they are used in practice, who is using them, and why they are not discriminatory or resulting in undue benefit or harm to any traders”); Citadel letter, infra note 214, at 4 (expressing the view that “dark pools should be subject to increased transparency,” and that “ATS operational information and filings should be publicly available”); KOR Group letter, infra note 175, at 12 (opining that the fact that “ATS filings are hidden from the public while the burden is on SROs to file publicly . . . does not serve the public interest in any way” and that there “should not be any reasoned argument against” making Form ATS publicly available); Liquidnet letter #1, infra note 166, at D-5-6, -11 (stating that the Commission should require institutional brokers, including institutional ATSs, to disclose to their customers specific order handling practices, including identification of external venues to which the broker routes orders, the process for crossing orders with other orders, execution of orders as agent and principal, a detailed description of the operation and function of each ATS or trading desk operated by the broker, and a clear and detailed description of each algorithm and order type offered by the broker and expressing the view that Form ATS should be made publicly available).

trading venue that best fits their needs. To illustrate this point, institutional investors would likely find it useful to know whether an NMS Stock ATS provides execution priority to customer order flow, uses strict price-time priority rules to rank and execute orders, or applies certain execution allocation methodologies for institutional orders. Such information could permit an institutional investor to compare NMS Stock ATSs against each other, as well as against national securities exchanges, to determine which trading centers would best fit its needs. Additionally, there may be market participants, who may not currently subscribe to an NMS Stock ATS, that may wish to obtain information about how a particular NMS Stock ATS operates before sending orders to that trading venue.

This proposal is primarily designed to provide market participants with greater transparency around the operations of NMS Stock ATSs and potential conflicts of interest that may arise involving the broker-dealer operator and its affiliates. The proposed rules would require public, detailed information to be disclosed about the activities of the broker-dealer operator and its affiliates in connection with the NMS Stock ATS, including: their operation of non-ATS trading centers and other NMS Stock ATSs; the products and services offered to subscribers; any arrangements with unaffiliated trading centers; trading activities on the NMS Stock ATS of the broker-dealer operator or its affiliates; the use of smart order routers ("SORs") (or similar functionality) and algorithms used to send or receive orders or other trading interest to or from the NMS Stock ATS; shared employees of the NMS Stock ATS and third parties used to operate the NMS Stock ATS; any differences in the availability of services, functionalities, or procedures to subscribers and the availability of those services, functionalities, or procedures to the broker-dealer operator or its affiliates; and the NMS Stock ATS's safeguards and procedures to protect subscribers' confidential trading information. Form ATS-N would also require

detailed information about the operations of the NMS Stock ATS, including: any eligibility requirements and any terms and conditions imposed for subscribers; the NMS Stock ATS's hours of operation; the types of orders or other trading interest that can be entered on the NMS Stock ATS; any connectivity, order entry, and co-location procedures or services; the segmentation of order flow (and notice given about segmentation); the display of order and other trading interest; trading services, including matching methodologies, order interaction rules, and order handling and execution procedures; procedures governing the suspension of trading and trading during a system disruption or malfunction; opening, re-opening, closing, and after hours processes or trading procedures; any outbound routing services; the NMS Stock ATS's use of market data; fees, rebates, or other charges of the NMS Stock ATS; any trade reporting, clearance or settlement arrangements or procedures; order display and execution access and fair access information (if applicable); and market quality statistics published or provided to one or more subscribers. The Commission preliminarily believes that greater transparency in this regard would provide important information to market participants so they can evaluate whether submitting order flow to a particular NMS Stock ATS aligns with their trading or investment objectives. Among other things, these enhanced, public disclosures also are designed to limit the potential that a broker-dealer operator of an NMS Stock ATS could provide certain subscribers with greater disclosure about the operations and system functionalities of the ATS than it provides to other market participants.

The Commission also preliminarily believes that proposing a process for the Commission to determine whether an NMS Stock ATS qualifies for the exemption from the Exchange Act definition of "exchange" would facilitate better Commission oversight of NMS Stock ATSs and

thus, better protection of investors.<sup>41</sup> The proposed process would provide the Commission with an opportunity to review disclosures on Form ATS-N for compliance with the Form ATS-N requirements, Regulation ATS, and other applicable requirements of the federal securities laws and regulations. To qualify for the exemption from the Exchange Act definition of “exchange,” an NMS Stock ATS would be required to file with the Commission a Form ATS-N, in accordance with the instructions therein, and the Form ATS-N would need to be declared effective by the Commission. The Commission would declare ineffective a Form ATS-N if it finds, after notice and opportunity for hearing, that such action is necessary or appropriate in the public interest and is consistent with the protection of investors.<sup>42</sup> If the Commission declares a Form ATS-N ineffective, the NMS Stock ATS would be prohibited from operating as an NMS Stock ATS,<sup>43</sup> but would not be prohibited from subsequently filing a new Form ATS-N. The Commission also preliminarily believes that proposing a process for the Commission to review and declare ineffective Form ATS-N Amendments, if it finds that such action is necessary or appropriate in the public interest and is consistent with the protection of investors, would aid the Commission’s ongoing oversight of NMS Stock ATSs.<sup>44</sup>

In this light, the Commission is proposing to amend Regulation ATS, including as follows: (1) define in proposed Rule 300(k) of Regulation ATS the term NMS Stock ATS,

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<sup>41</sup> See proposed Rule 304(a)(1)(i). See also *infra* Section IV.C.0 (discussing the proposed process for Commission review of Form ATS-N and circumstances under which an NMS Stock ATS may not qualify for the exemption, as well as the benefits that the process should provide to market participants).

<sup>42</sup> See proposed Rule 304(a)(1)(iii).

<sup>43</sup> See proposed Rule 304(a)(1)(iv).

<sup>44</sup> See *infra* Section IV.C.6 (discussing the proposed process for Commission review of amendments). See also proposed Rule 304(a)(2)(ii).

amend the definition of “control” under current Rule 300(f) of Regulation ATS to specify that control means to direct the management or policies of the broker-dealer of an ATS, and amend the exemption from the definition of “exchange” in Rule 3a1-1(a) to require NMS Stock ATSs to comply with proposed Rule 304 (in addition to the other requirements of Regulation ATS) as a condition of the exemption; (2) amend Rule 301(b)(2) to require NMS Stock ATSs to file the reports and amendments mandated by proposed Rule 304, which would include filing proposed Form ATS-N, in lieu of current Form ATS, to provide detailed disclosures about an NMS Stock ATS’s operations and the activities of its broker-dealer operator and its affiliates and amend Rule 301(b)(2) to require an ATS that effects transactions in both NMS stocks and non-NMS stocks to file the reports and amendments mandated by proposed Rule 304 for its NMS stock trading activity and the reports and amendments required under current Rule 301(b)(2) of Regulation ATS for its non-NMS stock trading activity; (3) amend Rule 301(b)(9) to require an ATS that trades both NMS stocks and non-NMS stocks to separately report its transactions in NMS stocks on one Form ATS-R, and its transactions in securities other than NMS stocks on another Form ATS-R; (4) provide a process for the Commission, pursuant to proposed Rule 304(a)(1), to declare a Form ATS-N effective or, after notice and opportunity for hearing, ineffective; (5) establish the requirements for amending Form ATS-N pursuant to proposed Rule 304(a)(2); (6) provide, pursuant to proposed Rule 304(a)(3), that a notice of cessation shall cause the Form ATS-N to be ineffective on the date designated by the NMS Stock ATS; (7) provide a process for the Commission, pursuant to proposed Rule 304(a)(4), to suspend, limit, or revoke the exemption of an NMS Stock ATS’s Form ATS-N upon notice and after opportunity for hearing; (8) provide that the Commission, pursuant to proposed Rule 304(b), will publicly post on its website: each effective Form ATS-N, each properly filed Form ATS-N Amendment, and each

properly filed Form ATS-N notice of cessation, as well as each order of effectiveness or ineffectiveness of a Form ATS-N, order of ineffectiveness of a Form ATS-N Amendment, and order suspending, limiting, or revoking an NMS Stock ATS's exemption, issued by the Commission; and also require each NMS Stock ATS that has a website to post on the NMS Stock ATS's website a direct URL hyperlink to the Commission's website that contains the documents enumerated in proposed Rule 304(b)(2); (9) amend existing Rule 301(b)(10) of Regulation ATS to require all ATSs to adopt written safeguards and written procedures to protect subscribers' confidential trading information, as well as written oversight procedures to ensure those safeguards and procedures are followed; and (10) amend Rule 303(a) to require that the written safeguards and written procedures required by proposed Rule 301(b)(10) and reports pursuant to proposed Rule 304 be preserved.

## II. Current ATS Regulatory Framework

### A. Exemption from National Securities Exchange Registration

A fundamental component of the current ATS regulatory framework adopted by the Commission in 1998 is Exchange Act Rule 3b-16.<sup>45</sup> Rule 3b-16 was designed to address the blurring of traditional classifications between exchanges and broker-dealers as a result of advances in technology by providing a more comprehensive and meaningful interpretation of what constitutes an exchange under Section 3(a) of the Exchange Act.<sup>46</sup> Rule 3b-16(a) provides a functional test to assess whether a trading platform meets the definition of exchange under Section 3(a)(1) of the Exchange Act, and thus is required to register as a national securities exchange pursuant to Sections 5 and 6 of the Exchange Act.<sup>47</sup> Under Rule 3b-16, an organization, association, or group of persons shall be considered to constitute, maintain, or provide “a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange,” if such organization, association, or group of persons: (1) brings together the orders for securities of multiple buyers and sellers; and (2) uses established, non-discretionary methods

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<sup>45</sup> See 17 CFR 240.3b-16.

<sup>46</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70847. Pursuant to Section 3(a)(1) of the Exchange Act, the statutory definition of “exchange” means “any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange....” 15 U.S.C. 78c(a)(1).

<sup>47</sup> See 15 U.S.C. 78e and 78f. A “national securities exchange” is an exchange registered as such under Section 6 of the Exchange Act.

(whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade.<sup>48</sup>

The Commission adopted Exchange Act Rule 3b-16(b) to explicitly exclude certain systems that the Commission believed did not meet the exchange definition.<sup>49</sup> Specifically, Rule 3b-16(b) excludes systems that perform only traditional broker-dealer activities, including: (1) systems that route orders to a national securities exchange, a market operated by a national securities association, or a broker-dealer for execution, or (2) systems that allow persons to enter orders for execution against the bids and offers of a single dealer if certain additional conditions are met.<sup>50</sup> Accordingly, a system is not included in the Commission's interpretation of "exchange" if: (1) the system fails to meet the two-part test in paragraph (a) of Rule 3b-16; (2) the system falls within one of the exclusions in paragraph (b) of Rule 3b-16; or (3) the

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<sup>48</sup> See 17 CFR 240.3b-16(a).

<sup>49</sup> See Regulation ATS Adopting Release, supra note 7, at 70852.

<sup>50</sup> See 17 CFR 240.3b-16(b). Specifically, Rule 3b-16(b)(2) excludes such systems that allow persons to enter orders for execution against the bids and offers of a single dealer if (i) as an incidental part of such activities, the system matches orders that are not displayed to any person other than the dealer and its employees; or (ii) in the course of acting as a market maker registered with [an SRO], the system displays the limit orders of the market maker's, or other broker-dealer's, customers, and in addition, (A) matches customer orders with those displayed limit orders, and (B) as an incidental part of its market making activities, the system crosses or matches orders that are not displayed to any person other than the market maker and its employees. See 17 CFR 240.3b-16(b)(2). The purpose of these exclusions was to encompass systems operated by third market makers, as well as those systems operated by dealers, primarily in debt securities, who display their own quotations to customers and other broker-dealers on a proprietary basis. Rule 3b-16(b)(2)(ii) was adopted to exclude registered market makers that display their own quotes and, in order to comply with a Commission or SRO rule, customer limit orders, and allow their customers and other broker-dealers to enter orders of execution against the displayed orders. Additionally, it was designed to allow registered market makers, as an incidental activity resulting from their market maker status, to match or cross orders for securities in which they make a market, even if those orders are not displayed. See Regulation ATS Adopting Release, supra note 7, at 70854.

Commission otherwise conditionally or unconditionally exempts<sup>51</sup> the system from the definition.

For those systems that meet the criteria of Rule 3b-16(a) and are not excluded under Rule 3b-16(b) of the Exchange Act,<sup>52</sup> Rule 3a1-1(a)(2)<sup>53</sup> provides an exemption from the definition of “exchange.” Specifically, Exchange Act Rule 3a1-1(a)(2) exempts from the Exchange Act Section 3(a)(1) definition of “exchange” an organization, association, or group of persons that complies with Regulation ATS,<sup>54</sup> which includes, among other things, the requirement to register as a broker-dealer.<sup>55</sup> Therefore, an organization, association, or group of persons that complies with Regulation ATS is not subject to Section 5 of the Exchange Act,<sup>56</sup> which requires that an “exchange” register with the Commission as a national securities exchange pursuant to Section 6 of the Exchange Act<sup>57</sup> or otherwise be exempt. Additionally, an ATS that is not required to register as a national securities exchange pursuant to Section 5 is not an SRO<sup>58</sup> and is not required to comply with applicable requirements.<sup>59</sup>

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<sup>51</sup> See 17 CFR 240.3b-16(e).

<sup>52</sup> See 17 CFR 240.3b-16(b).

<sup>53</sup> See 17 CFR 240.3a1-1(a)(2).

<sup>54</sup> See 17 CFR 240.3a1-1(a)(2). Rule 3a1-1 also provides two other exemptions from the definition of “exchange” for: (1) any ATS operated by a national securities association and (2) any ATS not required to comply with Regulation ATS pursuant to Rule 301(a) of Regulation ATS. See 17 CFR 240.3a1-1(a)(1) and (3).

<sup>55</sup> See 17 CFR 242.301(b)(1).

<sup>56</sup> 15 U.S.C. 78e.

<sup>57</sup> 15 U.S.C. 78f.

<sup>58</sup> See *supra* note 21 (setting forth the statutory definition of SRO).

<sup>59</sup> See, e.g., Section 19 of the Exchange Act, 15 U.S.C. 78s.

To satisfy the requirements of the Rule 3a1-1(a)(2) exemption, a system that otherwise meets the definition of an “exchange” must comply with Regulation ATS. An ATS that fails to comply with the requirements of Regulation ATS would no longer qualify for the exemption from the definition of an “exchange” provided under Exchange Act Rule 3a1-1(a)(2), and thus, risks operating as an unregistered exchange in violation of Section 5 of the Exchange Act.<sup>60</sup>

#### **B. Conditions to the ATS Exemption; Confidential Notice Regime**

Rule 300(a) of Regulation ATS defines an ATS as: “any organization, association, person, group of persons, or system: (1) [t]hat constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of [Rule 3b-16]; and (2) [t]hat does not: (i) [s]et rules governing the conduct of subscribers other than the conduct of such subscribers’ trading on such organization, association, person, group of persons, or system; or (ii) [d]iscipline subscribers other than by exclusion from trading.”<sup>61</sup> Governing the conduct of or disciplining subscribers are functions performed by an SRO that the Commission believes should be regulated as such.<sup>62</sup> Accordingly, pursuant to the

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<sup>60</sup> See 15 U.S.C. 78e.

<sup>61</sup> See 17 CFR 242.300(a).

<sup>62</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70859. As the Commission noted when it adopted Regulation ATS, the Commission believes that any system that uses its market power to regulate its participants should be regulated as an SRO. The Commission noted that it would consider a trading system to be “governing the conduct of subscribers” outside the trading system if it imposed on subscribers, as conditions of participation in trading, any requirements for which the trading system had to examine subscribers for compliance. In addition, the Commission stated its belief that if a trading system imposed as conditions of participation, directly or indirectly, restrictions on subscribers’ activities outside of the trading system, such a trading system should be a registered exchange or operated by a national securities association, but that the

definition in Rule 300(a), a trading system that performs SRO functions, or performs functions common to national securities exchanges, such as establishing listing standards, is precluded from the definition of ATS and would be required to register as a national securities exchange or be operated by a national securities association (or seek another exemption).<sup>63</sup>

Rule 301(b)(1) of Regulation ATS requires that every ATS that is subject to Regulation ATS, pursuant to paragraph (a) of Rule 301,<sup>64</sup> be registered as a broker-dealer under Section 15 of the Exchange Act,<sup>65</sup> and thus become a member of an SRO, such as FINRA.<sup>66</sup> In the Regulation ATS Adopting Release, the Commission stated that an ATS that registers as a broker-dealer must, in addition to complying with Regulation ATS, comply with the filing and conduct

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limitation would not preclude an alternative trading system from imposing credit conditions on subscribers or requiring subscribers to submit financial information to the alternative trading system. See id.

<sup>63</sup> See id.

<sup>64</sup> Pursuant to Rule 301(a), certain ATSS that are subject to other appropriate regulations are not required to comply with Regulation ATS, including any ATS that is: (1) registered as an exchange under Section 6 of the Exchange Act; (2) exempt from exchange registration based on the limited volume of transactions effected; (3) operated by a national securities association; (4) registered as a broker-dealer under Sections 15(b) or 15C of the Exchange Act, or is a bank, that limits its activities to certain instruments; or (5) exempted, conditionally or unconditionally, by Commission order, after application by such alternative trading system. See 17 CFR 242.301(a). For example, an ATS that is registered as a broker-dealer, or is a bank, and limits its securities activities solely to government securities is not required to comply with Regulation ATS. See 17 CFR 242.301(a)(4).

<sup>65</sup> See 17 CFR 242.301(b)(1).

<sup>66</sup> See Section 15(b)(8) of the Exchange Act; 15 U.S.C. 78o(b)(8). See also supra 24 note and infra note 294 and accompanying text (setting forth the requirements of Section 15(b)(8) of the Exchange Act).

obligations associated with being a registered broker-dealer, including membership in an SRO and compliance with SRO rules.<sup>67</sup>

In addition, Rule 301(b)(2) of Regulation ATS requires an ATS to file an initial operation report with the Commission on Form ATS<sup>68</sup> at least 20 days before commencing operations.<sup>69</sup> The Commission stated in the Regulation ATS Adopting Release that Form ATS would provide the Commission the opportunity to identify problems that might impact investors before the system begins to operate.<sup>70</sup> Unlike a Form 1 filed by a national securities exchange, Form ATS is not approved by the Commission. Instead, Form ATS provides the Commission with notice about its operations prior to commencing operations.<sup>71</sup>

Form ATS requires, among other things, that an ATS provide information about: classes of subscribers and differences in access to the services offered by the ATS to different groups or classes of subscribers; securities the ATS expects to trade; any entity other than the ATS involved in its operations; the manner in which the system operates; how subscribers access the trading system; procedures governing order entry and execution; and trade reporting, clearance and settlement of trades on the ATS. Regulation ATS states that information filed by an ATS on

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<sup>67</sup> See Regulation ATS Adopting Release, supra note 7, at 70903.

<sup>68</sup> Form ATS and the Form ATS Instructions are available at <http://www.sec.gov/about/forms/formats.pdf>.

<sup>69</sup> See 17 CFR 242.301(b)(2)(i).

<sup>70</sup> See Regulation ATS Adopting Release, supra note 7, at 70864.

<sup>71</sup> See id. As discussed more fully below, the current notice process applicable to ATSs is very different than the process by which exchanges register with the Commission and how amendments to exchange rules are regulated. See infra notes 158-162 and accompanying text.

Form ATS is “deemed confidential when filed.”<sup>72</sup> Thus, under the current regulatory requirements, market participants generally do not have information about, for example, how orders are entered, prioritized, handled, and executed on an NMS Stock ATS, ATSS are not otherwise required to publicly disclose such information.<sup>73</sup>

In addition to providing notice of its initial operation, an ATS must notify the Commission of any changes in its operations by filing an amendment to its initial operation report. There are three types of amendments to an initial operation report.<sup>74</sup> First, if any material change is made to its operations, the ATS must file an amendment on Form ATS at least 20 calendar days before implementing such change.<sup>75</sup> Second, if any information contained in the initial operation report becomes inaccurate for any reason and has not been previously reported to the Commission as an amendment on Form ATS, the ATS must file an amendment on Form ATS correcting the information within 30 calendar days after the end of the calendar quarter in which the system has operated.<sup>76</sup> Third, an ATS must promptly file an amendment on Form ATS correcting information that it previously reported on Form ATS after discovery that any

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<sup>72</sup> See 17 CFR 242.301(b)(2)(vii).

<sup>73</sup> The Commission does note, however, that some ATSS may currently make voluntary public disclosures. See, e.g., *infra* note 156.

<sup>74</sup> Form ATS is used for three types of submissions: (1) initial operation reports; (2) amendments to initial operation reports; and (3) cessation of operations reports. An ATS designates the type of submission on the form. See Form ATS.

<sup>75</sup> See 17 CFR 242.301(b)(2)(ii). A “material change,” includes, but is not limited to, any change to the operating platform, the types of securities traded, or the types of subscribers. In addition, the Commission has stated that ATSS implicitly make materiality decisions in determining when to notify their subscribers of changes. See Regulation ATS Adopting Release, *supra* note 7, at 70864. See also *supra* Section IV.C.IV.6 (discussing the proposed materiality standard that would apply to the filing of amendments on Form ATS-N).

<sup>76</sup> See 17 CFR 242.301(b)(2)(iii).

information was inaccurate when filed.<sup>77</sup> Also, upon ceasing to operate as an ATS, an ATS is required to promptly file a cessation of operations report on Form ATS.<sup>78</sup> As is the case with respect to initial operation reports, Form ATS amendments and cessation of operations reports serve as notice to the Commission of changes to the ATS's operations,<sup>79</sup> and Rule 301(b)(2)(vii) and the instructions to the form state that Form ATS is "deemed confidential."<sup>80</sup>

Rule 301(b)(9) of Regulation ATS also requires ATSs to periodically report certain information about transactions on the ATS and information about certain activities on Form ATS-R within 30 calendar days after the end of each calendar quarter in which the market has operated.<sup>81</sup> Form ATS-R requires quarterly volume information for specified categories of securities, as well as a list of all securities traded on the ATS during the quarter and a list of all subscribers that were participants during the quarter.<sup>82</sup> Form ATS-R also requires an ATS that is subject to the fair access obligations under Rule 301(b)(5) of Regulation ATS to: (1) provide a list of all persons granted, denied, or limited access to the ATS during the period covered by the ATS-R and (2) designate for each person: (a) whether they were granted, denied, or limited access; (b) the date the ATS took such action; (c) the effective date of such action; and (d) the

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<sup>77</sup> See 17 CFR 242.301(b)(2)(iv).

<sup>78</sup> See 17 CFR 242.301(b)(2)(v).

<sup>79</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70864.

<sup>80</sup> See 17 CFR 242.301(b)(2)(vii); Form ATS at 3, General Instructions A.7.

<sup>81</sup> See 17 CFR 242.301(b)(9)(i). Form ATS-R and the Form ATS-R Instructions are available at <https://www.sec.gov/about/forms/formats-r.pdf>.

<sup>82</sup> See Form ATS-R at 4, Items 1 and 2 (describing the requirements for Exhibit A and Exhibit B of Form ATS-R). ATSs must also complete and file Form ATS-R within 10 calendar days after ceasing to operate. See 17 CFR 242.301(b)(9)(ii); Form ATS-R at 2, General Instructions A.2 to Form ATS-R.

nature of any denial or limitation of access.<sup>83</sup> In the Regulation ATS Adopting Release, the Commission stated that the information provided on Form ATS-R would permit the Commission to monitor the trading on ATSS.<sup>84</sup> Like Form ATS, Rule 301(b)(2)(vii) and the instructions to Form ATS-R state that Form ATS-R is “deemed confidential.”<sup>85</sup>

In addition to the reporting requirements under Rules 301(b)(2) and 301(b)(9) of Regulation ATS, an ATS’s exemption from national securities exchange registration is conditioned on the ATS complying with the other requirements under Regulation ATS. Under Rule 301(b)(3), an ATS that (1) displays subscriber orders in an NMS stock to any person (other than an employee of the ATS) and (2) during at least four of the preceding six calendar months, had an average daily trading volume of 5% or more of the aggregate average daily share volume for that NMS stock, as reported by an effective transaction reporting plan, must:<sup>86</sup>

- pursuant to Rule 301(b)(3)(ii),<sup>87</sup> provide to a national securities exchange or national securities association the prices and sizes of the orders at the highest buy price and the lowest sell price for such NMS stock, displayed to more than one person in the ATS, for inclusion in the quotation data made available by the national securities exchange or national securities association pursuant to Rule 602 under Regulation NMS,<sup>88</sup> and

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<sup>83</sup> See Form ATS-R at 6, Item 7 (explaining requirements for Exhibit C).

<sup>84</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70878.

<sup>85</sup> See 17 CFR 242.301(b)(2)(vii); Form ATS-R at 2, General Instruction A.7.

<sup>86</sup> See 17 CFR 242.301(b)(3)(i).

<sup>87</sup> See 17 CFR 242.301(b)(3)(ii).

<sup>88</sup> See 17 CFR 242.602.

- pursuant to Rule 301(b)(3)(iii),<sup>89</sup> with respect to any such order displayed pursuant to Rule 301(b)(3)(ii), provide to any broker-dealer that has access to the national securities exchange or national securities association to which the ATS provides the prices and sizes of displayed orders pursuant to Rule 301(b)(3)(ii), the ability to effect a transaction with such orders that is:
  - equivalent to the ability of such broker-dealer to effect a transaction with other orders displayed on the exchange or by the association; and
  - at the price of the highest priced buy order or lowest priced sell order displayed for the lesser of the cumulative size of such priced orders entered therein at such price, or the size of the execution sought by such broker-dealer.

These order display and execution access obligations were adopted by the Commission with the expectation they would promote additional market integration and further discourage two-tier markets when trading in an NMS stock on an ATS reaches a certain level.<sup>90</sup>

Under Rule 301(b)(4), an ATS must not charge any fee to broker-dealers that access the ATS through a national securities exchange or national securities association that is inconsistent with the equivalent access to the ATS that is required under Rule 301(b)(3)(iii).<sup>91</sup>

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<sup>89</sup> See 17 CFR 242.301(b)(3)(iii).

<sup>90</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70867.

<sup>91</sup> See 17 CFR 242.301(b)(4). In addition, if the national securities exchange or national securities association to which an ATS provides the prices and sizes of orders under Rules 301(b)(3)(ii) and 301(b)(3)(iii) establishes rules designed to assure consistency with standards for access to quotations displayed on such national securities exchange, or the market operated by such national securities association, the ATS shall not charge any

Under Rule 301(b)(5) – and even if the ATS does not display subscribers’ orders to any person (other than an ATS employee) – an ATS with 5% or more of the average daily volume in an NMS stock during at least four of the preceding six calendar months, as reported by an effective transaction reporting plan, must:<sup>92</sup>

- establish written standards for granting access to trading on its system;
- not unreasonably prohibit or limit any person in respect to access to services offered by such ATS by applying the above standards in an unfair or discriminatory manner;
- make and keep records of:
  - all grants of access including, for all subscribers, the reasons for granting such access; and
  - all denials or limitations of access and reasons, for each applicant, for denying or limiting access; and
- report the information required in Exhibit C of Form ATS-R regarding grants, denials, and limitations of access.<sup>93</sup>

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fee to members that is contrary to, that is not disclosed in the manner required by, or that is inconsistent with any standard of equivalent access established by such rules. See id.

<sup>92</sup> 17 CFR 242.301(b)(5)(i).

<sup>93</sup> See 17 CFR 242.301(b)(5)(ii). Regulation ATS does not mandate compliance with these requirements when an ATS reaches the 5% trading threshold in an NMS stock if the following conditions are met:

- the ATS matches customer orders for a security with other customer orders;
- such customers’ orders are not displayed to any person, other than employees of the ATS; and
- such orders are executed at a price for such security disseminated by an effective transaction reporting plan, or derived from such prices.

See 17 CFR 242.301(b)(5)(iii).

The above requirements of Rule 301(b)(5) are referred to as the “fair access” requirements and apply on a security-by-security basis.<sup>94</sup> A denial of access to a market participant after an ATS reaches the above 5% fair access threshold in an NMS stock would be reasonable if it is based on objective standards.<sup>95</sup>

Additionally, under Rule 301(b)(6), an ATS that trades only municipal securities or corporate fixed income debt with 20% or more of the average daily volume traded in the U.S. during at least four of the preceding six calendar months, must do the following with respect to those systems that support order entry, order routing, order execution, transaction reporting, and trade comparison:<sup>96</sup>

- establish reasonable current and future capacity estimates;
- conduct periodic capacity stress tests of critical systems to determine such system’s ability to process transactions in an accurate, timely, and efficient manner;
- develop and implement reasonable procedures to review and keep current its system development and testing methodology;
- review the vulnerability of its systems and data center computer operations to internal and external threats, physical hazards, and natural disasters;
- establish adequate contingency and disaster recovery plans;

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<sup>94</sup> The fair access requirements also apply for non-NMS stocks when an ATS reaches a 5% trading threshold in certain securities other than NMS stocks, including certain equity securities, municipal securities and corporate debt securities. See 17 CFR 242.301(b)(5)(i).

<sup>95</sup> See Regulation ATS Adopting Release, supra note 7, at 70874.

<sup>96</sup> See 17 CFR 242.301(b)(6)(i).

- on an annual basis, perform an independent review, in accordance with established audit procedures and standards, of the ATS's controls for ensuring that the above requirements are met, and conduct a review by senior management of a report containing the recommendations and conclusions of the independent review; and
- promptly notify the Commission and its staff of material systems outages and significant systems changes.<sup>97</sup>

Prior to the Commission's adoption of Regulation SCI,<sup>98</sup> the requirements of Rule 301(b)(6) also applied to ATSS with regard to their trading in NMS stocks and non-NMS equity securities.<sup>99</sup>

Regulation SCI superseded and replaced Rule 301(b)(6)'s requirements with regard to ATSS that trade NMS stocks and non-NMS stocks.<sup>100</sup> In general, Regulation SCI requires SCI entities,<sup>101</sup>

<sup>97</sup> See 17 CFR 242.301(b)(6)(ii). Also, as with the fair access requirements pursuant to Rule 301(b)(5), Regulation ATS does not mandate compliance with the requirements under Rule 301(b)(6) when an ATS reaches a 20% trading threshold if the following conditions are met:

- the ATS matches customer orders for a security with other customer orders;
- such customers' orders are not displayed to any person, other than employees of the ATS; and
- such orders are executed at a price for such security disseminated by an effective transaction reporting plan, or derived from such prices.

See 17 CFR 242.301(b)(6)(iii).

<sup>98</sup> See SCI Adopting Release, supra note 17.

<sup>99</sup> See Regulation ATS Adopting Release, supra note 7, at 70875-76.

<sup>100</sup> Regulation SCI does not apply to ATSS that trade only municipal securities or corporate debt securities. See SCI Adopting Release, supra note 17, at 72262. Prior to the adoption of Regulation SCI, Rule 301(b)(6) of Regulation ATS imposed by rule certain aspects of Commission policy statements with respect to technology systems of significant-volume ATSS.

Specifically, Regulation SCI, with regard to SCI entities (as defined in Regulation SCI; see infra note 101), superseded and replaced the Commission's prior Automation Review Policy ("ARP"), established by the Commission's two policy statements, each titled

including NMS Stock ATSS that meet the definition of an “SCI ATS,”<sup>102</sup> to establish written policies and procedures reasonably designed to ensure that their systems have levels of capacity, integrity, resiliency, availability, and security adequate to maintain their operational capability and promote the maintenance of fair and orderly markets, and that they operate in a manner that complies with the Exchange Act.<sup>103</sup> In addition, Regulation SCI requires SCI entities, including NMS Stock ATSS that are SCI entities, to take corrective action with respect to SCI events (defined to include systems disruptions, systems compliance issues, and systems intrusions), and notify the Commission of such events.<sup>104</sup> Regulation SCI further requires SCI entities, including NMS Stock ATSS that are SCI entities, to disseminate information about certain SCI events to

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“Automated Systems of Self-Regulatory Organizations,” issued in 1989 and 1991, see Securities Exchange Act Release Nos. 27445 (November 16, 1989), 54 FR 48703 (November 24, 1989), and 29185 (May 9, 1991), 56 FR 22490 (May 15, 1991), including the aspects of those policy statements previously codified in Rule 301(b)(6) of Regulation ATS applicable to significant-volume ATSS that trade NMS stocks and non-NMS stocks. See SCI Adopting Release, supra note 17, at 72252.

<sup>101</sup> Regulation SCI defines “SCI entity” to mean “an SCI self-regulatory organization, SCI alternative trading system, plan processor, or exempt clearing agency subject to [the Commission’s Automation Review Policies].” See 17 CFR 242.1000.

<sup>102</sup> Regulation SCI defines “SCI alternative trading system” or “SCI ATS” to mean an ATS, which during at least four of the preceding six calendar months: (1) had with respect to NMS stocks (a) five percent (5%) or more in any single NMS stock, and one-quarter percent (0.25%) or more in all NMS stocks, of the average daily dollar volume reported by applicable transaction reporting plans, or (b) one percent (1%) or more in all NMS stocks of the average daily dollar volume reported by applicable transaction reporting plans; or (2) had with respect to equity securities that are not NMS stocks and for which transactions are reported to a self-regulatory organization, five percent (5%) or more of the average daily dollar volume as calculated by the self-regulatory organization to which such transactions are reported. However, an SCI ATS is not required to comply with the requirements of Regulation SCI until six months after satisfying the aforementioned criteria. See 17 CFR 242.1000.

<sup>103</sup> See SCI Adopting Release, supra note 17, at 72252.

<sup>104</sup> See id.

affected members or participants and, for certain major SCI events, to all members or participants of the SCI entity. In addition, Regulation SCI requires SCI entities, including NMS Stock ATs that are SCI entities, to conduct a review of their systems by objective, qualified personnel at least annually, submit quarterly reports regarding completed, ongoing, and planned material changes to their SCI systems to the Commission, and maintain certain books and records.<sup>105</sup> It also requires SCI entities, including NMS Stock ATs that are SCI entities, to mandate participation by designated members or participants in scheduled testing of the operation of their business continuity and disaster recovery plans, including backup systems, and to coordinate such testing on an industry- or sector-wide basis with other SCI entities.<sup>106</sup> Regulation SCI, as compared to the former Rule 301(b)(6), also modified the volume thresholds applicable to SCI ATs.<sup>107</sup>

Rule 301(b)(7)<sup>108</sup> requires all ATs, regardless of the volume traded on their systems, to permit the examination and inspection of their premises, systems, and records, and cooperate with the examination, inspection, or investigation of subscribers, whether such examination is being conducted by the Commission or by an SRO of which such subscriber is a member. Rule

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<sup>105</sup> See id.

<sup>106</sup> See id.

<sup>107</sup> See supra note 102. Prior to the adoption of Regulation SCI, the requirements of Rule 301(b)(6) also applied to ATs that, during at least 4 of the preceding 6 calendar months, had with respect to any NMS stock, 20% or more of the average daily volume reported by an effective transaction reporting plan.

<sup>108</sup> See 17 CFR 242.301(b)(7).

301(b)(8)<sup>109</sup> requires all ATSS to make and keep current the records specified in Rule 302 of Regulation ATS<sup>110</sup> and preserve the records specified in Rule 303 of Regulation ATS.<sup>111</sup>

Under Rule 301(b)(10), all ATSS must establish adequate safeguards and procedures to protect subscribers' confidential trading information, which must include the following:

- limiting access to the confidential trading information of subscribers to those employees of the ATS who are operating the system or responsible for its compliance with these or any other applicable rules; and
- implementing standards controlling employees of the ATS trading for their own accounts.<sup>112</sup>

Furthermore, all ATSS must adopt and implement adequate oversight procedures to ensure that the above safeguards and procedures are followed.<sup>113</sup>

Finally, Rule 301(b)(11)<sup>114</sup> expressly prohibits any ATS from using the word "exchange" or derivations of the word "exchange," such as the term "stock market," in its name.<sup>115</sup>

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<sup>109</sup> See 17 CFR 242.301(b)(8).

<sup>110</sup> See 17 CFR 242.302.

<sup>111</sup> See 17 CFR 242.303. In the Regulation ATS Adopting Release, the Commission stated that these requirements to make, keep, and preserve records are necessary to create a meaningful audit trail and to permit surveillance and examination to help ensure fair and orderly markets. See Regulation ATS Adopting Release, *supra* note 7, at 70877-78.

<sup>112</sup> See 17 CFR 242.301(b)(10)(i).

<sup>113</sup> See 17 CFR 242.301(b)(10)(ii).

<sup>114</sup> See 17 CFR 240.301(b)(11).

<sup>115</sup> When the Commission proposed Regulation ATS, it said that "it is important that the investing public not be confused about the market role [ATSS] have chosen to assume." See Securities Exchange Act Release No. 39884 (April 21, 1998), 63 FR 23504, 23523 (April 29, 1998) ("Regulation ATS Proposing Release"). The Commission expressed concern that "use of the term 'exchange' by a system not regulated as an exchange would

### III. Role of ATSS in the Current Equity Market Structure

#### A. Significant Source of Liquidity for NMS Stocks

The equity market structure in 1998 was starkly different than it is today. At the time Regulation ATS was proposed, there were only 8 registered national securities exchanges,<sup>116</sup> and the Commission estimated that there were approximately 43 systems that would be eligible to operate as ATSS.<sup>117</sup> Currently, there are 18 registered national securities exchanges, of which there are 11 national securities exchanges that trade NMS stocks,<sup>118</sup> and 84 ATSS with a Form ATS on file with the Commission. Currently, there are 46 ATSS that have noticed on their Form ATS that they expect to trade NMS stocks.<sup>119</sup> As the Commission noted in the SCI Adopting Release, even smaller trading centers, such as certain high-volume ATSS, now collectively represent a significant source of liquidity for NMS stocks, and some ATSS have similar and, in some cases, greater trading volume than some national securities exchanges.<sup>120</sup> In the second quarter of 2015, there were 38 ATSS that reported transactions in NMS stocks, accounting for 59 billion shares traded in NMS stocks (\$2.5 trillion), and represented approximately 15.0% of total share trading volume (15.4% of total dollar trading volume) on all national securities exchanges,

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be deceptive and could mislead investors that such alternative trading system is registered as a national securities exchange.” See id.

<sup>116</sup> See Regulation ATS Proposing Release, supra note 115, at 23543 n.341.

<sup>117</sup> See id. at 23540 n.313 and accompanying text.

<sup>118</sup> The Commission notes that National Stock Exchange, Inc. ceased trading on its system as of the close of business on May 30, 2014. See Securities Exchange Act Release No. 72107 (May 6, 2014), 79 FR 27017 (May 12, 2014) (SR-NSX-2014-14).

<sup>119</sup> Data compiled from Forms ATS submitted to the Commission as of November 1, 2015.

<sup>120</sup> See SCI Adopting Release, supra note 17, at 72262.

ATSS, and non-ATS OTC trading venues combined.<sup>121</sup> During this period, no individual ATS executed more than approximately 13% of the total share volume on NMS Stock ATSS and no more than approximately 2% of total NMS stock share volume.<sup>122</sup> Given this dispersal of trading

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<sup>121</sup> See *infra* Table 1 – “NMS Stock ATSS Ranked by Dollar Trading Volume – March 30, 2015 to June 26, 2015.” Total dollar trading volume on all exchanges and off-exchange trading in the second quarter of 2015 was approximately \$16.3 trillion and approximately 397 billion shares. See Market Volume Summary, [https://www.batstrading.com/market\\_summary/](https://www.batstrading.com/market_summary/). See also *infra* Section XIII.B.1.

Competitors for listed-equity (NMS) trading services also include several hundred OTC market makers and broker-dealers.

<sup>122</sup> The NMS Stock ATS with the greatest volume executed approximately 12.7% of NMS Stock ATS share volume and 1.9% of the total consolidated NMS stock share trading volume.

The market share percentages were calculated by Commission staff using market volume statistics reported by BATS and FINRA ATS data collected from ATSS pursuant to FINRA Rule 4552. See *infra* Table 1 – “NMS Stock ATSS Ranked by Dollar Trading Volume – March 30, 2015 to June 26, 2015.”

FINRA recently adopted a rule that requires NMS Stock ATSS to report aggregate weekly volume information and number of trades to FINRA in certain equity securities, including NMS stocks, some of which FINRA makes publicly available. Reporting is on a security-by-security basis for transactions occurring within the ATS. Each ATS is also required to use a unique MPID in its reporting to FINRA, such that its volume reporting is distinguishable from other transaction volume reported by the broker-dealer operator of the ATS, including volume reported for other ATSS operated by the same broker-dealer. See FINRA Rules 4552, 6160, 6170, 6480 and 6720. See also Securities Exchange Act Release No. 71341 (January 17, 2014), 79 FR 4213 (January 24, 2014) (SR-FINRA-2013-042) (order granting approval of a proposed rule change to require alternative trading systems to report volume information to FINRA and use a unique market participant identifier) (“FINRA ATS Reporting Approval”).

FINRA publishes on its website the trading information (volume and number of trades) reported for each equity security, with appropriate disclosures that the information is based on ATS-submitted reports and not on reports produced or validated by FINRA. See *id.* at 4214. See also Alternative Trading System (ATS) Transparency on FINRA’s website, available at <http://www.finra.org/Industry/Compliance/MarketTransparency/ATS/>.

volume in NMS stocks among an increasing number of trading centers, NMS Stock ATSS, with their approximately 15% market share, represent a significant source of liquidity in NMS stocks.

Another significant aspect of the increased role of NMS Stock ATSS in equity market structure is the proliferation of ATSS that trade NMS stocks but do not publicly display quotations in the consolidated quotation data, commonly referred to as “dark pools.”<sup>123</sup> Dark pools originally were designed to offer certain market participants, particularly institutional investors, the ability to minimize transaction costs when executing trades in large size by completing their trades without prematurely revealing the full extent of their trading interest to the broader market. The disclosure of large size trades could have an impact on the market, and reduce the likelihood of the orders being filled.<sup>124</sup> As the Commission has previously noted, some dark pools, such as block crossing networks, offer specialized size discovery mechanisms that attempt to bring large buyers and sellers in the same stock together anonymously and to facilitate a trade between them.<sup>125</sup> The traditional definition of block orders are orders for more

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<sup>123</sup> The term “dark pool” is not used or defined in the Exchange Act or Commission rules. For purposes of this release, the term refers to NMS Stock ATSS that do not publicly display quotations in the consolidated quotation data. See Regulation of Non-Public Trading Interest, Securities Exchange Act Release No. 60997 (November 13, 2009), 74 FR 61208; 61209 (November 23, 2009) (“Regulation of Non-Public Trading Interest”) (proposing rules and amendment to joint-industry plans describing the term dark pool).

Some trading centers, such as OTC market makers, also offer dark liquidity, primarily in a principal capacity, and do not operate as ATSS. For purposes of this release, these trading centers are not defined as dark pools because they are not ATSS. These trading centers may, however, offer electronic dark liquidity services that are analogous to those offered by dark pools. See id. at 61209 n.8.

<sup>124</sup> See, e.g., Securities Exchange Act Release No. 61358 (January 14, 2010), 75 FR 3594, 3599 n.28 (January 21, 2010) (“2010 Equity Market Structure Release”).

<sup>125</sup> See id. at 3599.

than 10,000 shares,<sup>126</sup> however average trade sizes can far exceed this and be as high as 500,000 shares per trade.<sup>127</sup>

Most dark pools today, however, primarily execute trades with small sizes that are more comparable to the average size of trades on registered national securities exchanges, which is 181 shares.<sup>128</sup> These dark pools that primarily match smaller orders (though the matched orders may be “child” orders of much larger “parent” orders) execute more than 90% of dark pool volume.<sup>129</sup> The majority of this volume is executed by dark pools that are operated by multi-service broker-dealers.<sup>130</sup> These broker-dealers typically also offer order routing services, trade as principal in the ATS that they are operating, or both.<sup>131</sup>

In recent years, as the number of NMS Stock ATSs has increased, so has the number of dark pools. The number of active dark pools trading NMS stocks has increased from approximately 10 in 2002,<sup>132</sup> to 32 in 2009,<sup>133</sup> to over 40 today.<sup>134</sup> Furthermore, in 2009, dark

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<sup>126</sup> See Rule 600(b)(9) of Regulation NMS (defining block size with respect to an order), 17 CFR 242.600(b)(9). See also Laura Tuttle, Alternative Trading Systems: Description of ATS Trading in National Market System Stocks, at 9-10 (October 2013), available at <http://www.sec.gov/marketstructure/research/alternative-trading-systems-march-2014.pdf> (“Tuttle: ATS Trading in NMS Stocks”).

<sup>127</sup> See infra, Table 2 – “NMS Stock ATSs Ranked by Average Trade Size – March 30, 2015 to June 26, 2015.”

<sup>128</sup> See infra note 719 and accompanying text.

<sup>129</sup> See 2010 Equity Market Structure Release, supra note 124, 75 FR at 3599; see also infra, Table 2 – “NMS Stock ATSs Ranked by Average Trade Size – March 30, 2015 to June 26, 2015.”

<sup>130</sup> See infra note 362 and accompanying text and Table 1 – “NMS Stock ATSs Ranked by Dollar Trading Volume – March 30, 2015 to June 26, 2015.”

<sup>131</sup> See 2010 Equity Market Structure Release, supra note 124, at 3599.

<sup>132</sup> See Regulation of Non-Public Trading Interest, supra note 123, at 61209 n.9 and accompanying text.

pools accounted for 7.9% of NMS share volume.<sup>135</sup> It is now estimated that of the approximately 397 billion shares traded in NMS stocks (\$16.3 trillion), 14.9% of total NMS stock share volume is attributable to dark pools, with no single individual dark pool executing more than 1.9% of total NMS stock share volume.<sup>136</sup> The Commission also notes that some NMS Stock ATSs, which do not provide their best priced-orders for inclusion in the consolidated quotation data, make available to subscribers real-time information about quotes, orders, or other trading interest on the NMS Stock ATS.

In contrast to dark pools, an ATS could be an Electronic Communication Network (“ECN”). ECNs are ATSs that provide their best-priced orders for inclusion in the consolidated quotation data, whether voluntarily or as required by Rule 301(b)(3) of Regulation ATS.<sup>137</sup> In general, ECNs offer trading services (such as displayed or non-displayed order types, maker-taker pricing, and data feeds) that are analogous to registered national securities exchanges.<sup>138</sup>

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<sup>133</sup> See 2010 Equity Market Structure Release, supra note 124, at 3598 n.22 and accompanying text.

<sup>134</sup> Data compiled from Forms ATS and Forms ATS-R filed to the Commission as of the end of, and for the third quarter of, 2015.

<sup>135</sup> See 2010 Equity Market Structure Release, supra note 124, at 3598.

<sup>136</sup> See infra Section XIII.B.1.

<sup>137</sup> See Rule 600(b)(23) of Regulation NMS, 17 CFR 242.600(b)(23) (definition of “electronic communications network”); see also 2010 Equity Market Structure Release, supra note 124, at 3599.

<sup>138</sup> See 2010 Equity Market Structure Release, supra note 124, at 3599. See infra note 490 (describing the maker-taker pricing model).

## B. Heightened Operational Complexity and Sophistication of NMS Stock ATSS

Since Regulation ATS was adopted, ATSS have gained market share in NMS stocks and have also evolved to become more complex and sophisticated trading centers. In addition, ATSS that transact in NMS stocks increasingly are operated by multi-service broker-dealers that engage in significant brokerage and dealing activities in addition to their operation of their ATSS, and the operations of NMS Stock ATSS have become increasingly intertwined with operations of their broker-dealer operator, adding to the complexity of the manner in which those ATSS operate.<sup>139</sup> The Commission is concerned that market participants have limited information about the complex operations of NMS Stock ATSS and the unique relationship between an NMS Stock ATS and its broker-dealer operator and the affiliates of the broker-dealer operator, who often provide a significant source of liquidity on the NMS Stock ATS. The Commission preliminarily believes that improving transparency of information available to market participants would enable them to better assess NMS Stock ATSS as potential trading venues.<sup>140</sup>

Since Regulation ATS was adopted, ATSS that effect transactions in NMS stocks have grown increasingly complex in terms of the services and functionalities that they offer subscribers. Over the past 16 years, these ATSS, like registered national securities exchanges, have used advances in technology to improve the speed, capacity, and efficiency of their trading

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<sup>139</sup> As exemplified by some commenters' responses and as discussed further below, market participants are interested in information about, among other things, ATS affiliations, sharing of order information, operation of smart order routers and to whom they give preference, priority rules, order types, calculation of reference prices, and segmentation. See, e.g., *infra* notes 186 and 190 and accompanying text (describing comments received from Blackrock, Inc. and Bloomberg Tradebook LLC).

<sup>140</sup> See, e.g., *infra* note 187 and accompanying text (describing a comment received from the Consumer Federation of America).

functionalities to bring together the orders in NMS stocks of multiple buyers and sellers using established, non-discretionary methods under which such orders interact and trade. Before Regulation ATS was adopted, ATSS primarily operated as ECNs, as dark pools were not prevalent during that period. Today, the vast majority of NMS Stock ATSS operate as dark pools. Furthermore, based on Commission experience, ATSS that traded NMS stocks prior to the adoption of Regulation ATS did not offer the same services and functionalities as they do today. Today, most NMS Stock ATSS, like most registered national securities exchanges, are fully-electronic, automated systems that provide a myriad of trading services to facilitate order interaction among various types of users on the NMS Stock ATS. For example, NMS Stock ATSS offer a wide range of order types, which are a primary means by which subscribers communicate their instructions for the handling of their orders on the ATS. Based on Commission experience, some NMS Stock ATSS allow subscribers to submit indications of interests, conditional orders, and various types of pegged orders, often with time-in-force, or other specifications, which are similar to those offered by exchanges, such as all or none, minimum execution quantity, immediate or cancel, good till cancelled, and day. Unlike registered national securities exchanges, however, most NMS Stock ATSS have adopted a dark trading model, and do not display any quotations in the consolidated quotation data.

Additionally, at the time Regulation ATS was adopted, SORs were not a primary point of access to ATSS that trade NMS stocks. Today, however, brokers compete to offer sophisticated technology tools to monitor liquidity at many different venues and to implement order routing strategies.<sup>141</sup> Using that knowledge of available liquidity, many brokers offer smart order

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<sup>141</sup> See 2010 Equity Market Structure Release, supra note 124, 75 FR at 3602.

routing technology to route orders to various trading centers to access such liquidity.<sup>142</sup> Based on Commission experience, broker-dealer operators frequently use SORs (or similar functionality) to route orders to their NMS Stock ATSS in today's marketplace. Furthermore, for some NMS Stock ATSS, most orders must pass through the broker-dealer operator's SOR (or similar functionality) to enter the ATS.<sup>143</sup>

In today's highly automated trading environment, NMS Stock ATSS offer various matching systems to bring together orders and counterparties in NMS stocks. These automated matching systems, including limit order books, crossing systems, and various types of auctions, are generally pre-programmed to execute orders pursuant to established non-discretionary methods. These established non-discretionary methods dictate the terms of trading among multiple buyers and sellers entering orders into the NMS Stock ATS and generally include priority and allocation procedures. Based on Commission experience, some NMS Stock ATSS offer price-time priority, while others offer midpoint only matching with time priority, or time priority at other prices derived from the NBBO. Some NMS Stock ATSS may also offer priority mechanisms with additional overlays. For example, amongst orders at a given price, priority may be given to a certain type of order (e.g., agency orders), before then applying time priority. Additionally, some NMS Stock ATSS offer order routing services similar to those offered by national securities exchanges.<sup>144</sup>

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<sup>142</sup> See id.

<sup>143</sup> For a further discussion about the increased use of SORs (or similar functionalities) by broker-dealer operators of NMS Stock ATSS, see infra Section VII.B.7.

<sup>144</sup> For example, based on Commission experience, some NMS Stock ATSS, like national securities exchanges, will route a subscriber's order to another trading center when the

Some NMS Stock ATSS also offer subscribers the ability to further customize trading parameters, or the broker-dealer operator may set parameters around the interaction of various order flow. Based on Commission experience with information disclosed on Form ATS, some NMS Stock ATSS may enable subscribers to select the types of, or even specific, subscriber or order flow with which the subscriber wishes to interact. For example, some NMS Stock ATSS may enable subscribers to prevent their orders from interacting with principal order flow of the ATS's broker-dealer operator, or may enable subscribers to prohibit execution of their order flow against that of subscribers with certain execution characteristics (e.g., so called high-frequency traders or "HFTs"). Subscribers may also have the option to prevent self-matching with other order flow originating from the same firm. Some NMS Stock ATSS may also segment order flow into various classifications of subscribers based upon parameters set by the broker-dealer operator, such as historical execution characteristics, or may limit access to certain crossing mechanisms based on a subscriber's profile (e.g., the system may be programmed such that institutional order flow only executes against other institutional order flow).<sup>145</sup> Subscribers may or may not be aware that they have been classified as a particular type of participant on the NMS Stock ATS, which may limit their ability to interact with order flow of certain other subscribers to that NMS Stock ATS.

The Commission also preliminarily believes that, since Regulation ATS was adopted, the operations of NMS Stock ATSS have become increasingly intertwined with operations of the

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NMS Stock ATS cannot execute the order without trading through the NBBO, or if otherwise directed by the subscriber.

<sup>145</sup> A purported reason for such segmentation may be to help reduce information leakage or the possibility of trading with undesirable counterparties.

broker-dealer operator, providing additional complexity to the manner in which NMS Stock ATSS operate. Given this close relationship, the Commission preliminarily believes that conflicts of interest can arise between the broker-dealer operator's interest in its NMS Stock ATS and its interest in its other non-ATS businesses. As discussed further below, at the time Regulation ATS was adopted, the Commission recognized that broker-dealer operators may perform additional functions other than the operation of their ATS, such as other trading services, and adopted Rule 301(b)(10), which requires that ATSS have safeguards and procedures to protect confidential subscriber trading information.<sup>146</sup> The Commission is concerned that today, the potential for conflicts of interest as a result of a broker-dealer operator's other business interests, including those of its affiliates, may be greater than it was at that time, particularly due to trading centers that multi-service broker-dealer operators own and operate.<sup>147</sup> Additionally, the broker-dealer operator of an NMS Stock ATS controls all aspects of the operation of the ATS, including, among other things: means of access; who may trade; how orders interact, match, and execute; market data used for prioritizing or executing orders; display of orders and trading interest, and determining the availability of ATS services among subscribers.<sup>148</sup> The non-ATS operations of a broker-dealer operator and its NMS Stock ATS typically are connected in many ways. For example, in some cases, the broker-dealer operator, or its affiliates, owns,

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<sup>146</sup> See infra Part IX.

<sup>147</sup> See infra Section VII.A (discussing the activities of broker-dealer operators of NMS Stock ATSS and the possible conflicts of interest that may result, and the Commission's preliminary belief that providing market participants with information about such activities will enable market participants to assess whether potential conflicts of interest exist so that they may make more informed decisions about whether to send their order flow to a particular NMS Stock ATS).

<sup>148</sup> See infra Section VII.A.1.

and controls access to, the technology and systems that support the trading facilities of the NMS Stock ATS, and provides and directs personnel to service the trading facilities of the ATS. As discussed in more detail below,<sup>149</sup> the Commission is aware that most NMS Stock ATSs are operated by broker-dealers that also engage in brokerage and dealing activities, and offer their customers a variety of brokerage services, including algorithmic trading software, agency sales desk support, and automated smart order routing services, often with, or through, their affiliates. In addition, multi-service broker-dealers and their affiliates may operate, among other things, an OTC market making desk or proprietary trading desk in addition to operating an ATS, or may have other business units that actively trade NMS stocks on a principal or agency basis in the ATS or at other trading centers. Furthermore, the broker-dealer operator of an NMS Stock ATS may have arrangements with third-parties to perform certain aspects of its ATS's operations, and affiliates of those third parties may subscribe to the NMS Stock ATS, which the Commission is concerned give rise to the potential for information leakage or conflicts of interest, of which market participants may be unaware.<sup>150</sup>

As discussed further below, the Commission preliminarily believes that details about the operations and trading services of ATSs, such as those described above, are useful to market participants' understanding of the terms and conditions under which their orders will be handled and executed on a given ATS.<sup>151</sup> The Commission also preliminarily believes that market participants should have access to information about the relationship between a broker-dealer, its

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<sup>149</sup> See *id.*

<sup>150</sup> See *infra* Sections VII.B.6 and 9 (discussing trading on the ATS by the broker-dealer operator and its affiliates, and the relationship between an NMS Stock ATS and its service providers, and proposing to require related disclosure).

<sup>151</sup> See generally *infra* Sections VII and VIII.

affiliates, and the NMS Stock ATS that it operates, to adequately understand the operations of the ATS and potential conflicts of interest that may arise.

### **C. Lack of Operational Transparency for NMS Stock ATSs**

The Commission believes that one of the most important functions it can perform for investors is to ensure that they have access to the information they need to protect and further their own interests.<sup>152</sup> As noted above, although transparency has long been a hallmark of the U.S. securities markets and is one of the primary tools used by investors to protect their interests, market participants have limited knowledge of the operations of ATSs and how orders interact, match, and execute on ATSs.<sup>153</sup> The Commission is concerned that market participants have limited information about the non-ATS activities of the broker-dealer operators of NMS Stock ATSs and potential conflicts of interest that might arise from those activities.<sup>154</sup> The Commission is also concerned that different classes of subscribers may have different levels of information about the operations of NMS Stock ATSs and how their orders or other trading interests may interact on the NMS Stock ATS. To address these concerns, the Commission's proposal is designed to provide better access to information about the operations of NMS Stock ATSs to all market participants, including subscribers and potential subscribers.

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<sup>152</sup> See, e.g., Securities Exchange Act Release No. 42208, 64 FR 70613, 70614 (December 17, 1999) (concept release reviewing regulation of market information fees and revenues).

<sup>153</sup> See *supra* notes 40 and 139 (citing prior comment letters expressing the view that Form ATS should be made publicly available and expressing support for making publicly available ATS filings with the Commission, and exemplifying the kinds of information about NMS Stock ATS operations that market participants, including broker-dealers and intuitional investors, seek, but to which they may not currently have access).

<sup>154</sup> See *infra* Section VII.A.

Under current rules, a Form ATS is “deemed confidential when filed.”<sup>155</sup> As a result, market participants typically have, at best, limited access to Form ATS filings and the information contained therein. Additionally, Form ATS discloses only limited aspects of an ATS’s operations, and the Commission preliminarily believes that even where an ATS has voluntarily made public its Form ATS,<sup>156</sup> market participants currently might not be able to obtain a complete understanding of how ATSs operate. In addition, Form ATS does not solicit information about possible circumstances that give rise to potential conflicts of interest resulting from the activities of the broker-dealer operator and its affiliates. Despite the confidentiality afforded Form ATS, based on Commission experience, including the Commission’s experience reviewing disclosures made by ATSs on Form ATS over the past 16 years, ATSs have often provided minimal, summary disclosures about their operations on Form ATS. Furthermore, the Commission preliminarily believes that the complexity of the operations of NMS Stock ATSs has increased substantially and in a manner that causes the current disclosure requirements of

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<sup>155</sup> See 17 CR 242.301(b)(2)(vii). The information on Form ATS is available for examination by staff, state securities authorities, and SROs. See Form ATS at 3, Instruction A.7.

<sup>156</sup> The Commission notes that some ATSs have chosen to make Form ATS filings publicly available. See, e.g., IEX ATS Form ATS Amendment, dated July 29, 2015, available at <http://www.iextrading.com/policy/ats/>; PDQ ATS Inc’s Form ATS Amendment, dated January 30, 2015, available at [http://www.pdqats.com/wp-content/uploads/2013/10/PDQ-FORM-ATS-FILING\\_01\\_30\\_15-website.pdf](http://www.pdqats.com/wp-content/uploads/2013/10/PDQ-FORM-ATS-FILING_01_30_15-website.pdf); Liquidnet H2O ATS Form ATS Amendment, dated February 4, 2015, available at [http://www.liquidnet.com/uploads/ATS\\_\(H2O\)\\_Form-Exhibits\\_CLEAN\\_4feb2015.pdf](http://www.liquidnet.com/uploads/ATS_(H2O)_Form-Exhibits_CLEAN_4feb2015.pdf); SIGMA X Form ATS Amendment, dated May 21, 2014, available at <http://www.goldmansachs.com/media-relations/in-the-news/current/pdf-media/gs-form-ats-amendment.pdf>; POSIT Form ATS Amendment, dated January 26, 2015, available at [http://www.itg.com/marketing/ITG\\_Form\\_ATS\\_for\\_POSIT\\_02112015.pdf](http://www.itg.com/marketing/ITG_Form_ATS_for_POSIT_02112015.pdf).

Form ATS to result in a potentially insufficient, and inconsistent, level of detail about the operations of NMS Stock ATSs.

By comparison, national securities exchanges, with which NMS Stock ATSs directly compete, are subject to comprehensive registration and rule filing requirements under Section 19(b) of the Exchange Act.<sup>157</sup> Under these requirements, national securities exchanges must make public their trading rules and detail their trading operations. As discussed above, national securities exchanges register with the Commission on Form 1, and thereafter file proposed rule changes on Form 19b-4, which are not confidential, are approved by the Commission or become effective by operation of law, and are made public.<sup>158</sup> These mandatory filings publicly disclose, among other things, details about the exchange's trading services, operations, order types, order interaction protocols, priority procedures, and fees.<sup>159</sup> A national securities exchange must file such a proposed rule change any time it seeks to change its rules,<sup>160</sup> and even non-controversial rule changes cannot be implemented until the exchange files a Form 19b-4 with the

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<sup>157</sup> 15 USC 78s(b).

<sup>158</sup> See generally 15 U.S.C. 78s(a) and (b); and 17 CFR 240.19b-4. See also supra notes 20-23 and accompanying text; <http://www.sec.gov/rules/sro.shtml>.

<sup>159</sup> Among other things, Form 1 requires an exchange applying for registration as a national securities exchange to disclose its procedures governing entry and display of quotations and orders in its system, procedures governing the execution, reporting, clearance and settlement of transactions in connection with the system, and fees. See Form 1, Exhibits E.2-E.4. The disclosures required in Form 1 must include sufficient detail for the Commission to determine the exchange's rules are consistent with the Act. See generally 15 U.S.C. 78f(b)(1). Once registered, a national securities exchange must file any proposed rule or any proposed change in, addition to, or deletion from its rules. See 15 U.S.C. 78s(b)(2).

<sup>160</sup> See 15 U.S.C. 78s(b)(1).

Commission.<sup>161</sup> In contrast, an ATS can change its operations in certain cases before notifying the Commission, and in all cases, without obtaining Commission approval or notifying ATS subscribers or the public about the change.<sup>162</sup>

The Commission preliminarily believes that the increased complexity of NMS Stock ATS operations and the business structures of their broker-dealer operators, combined with a lack of transparency around the operation of NMS Stock ATSs and the activities of their broker-dealer operators, could inhibit a market participant's ability to assess an NMS Stock ATS as a potential trading venue. Further, the Commission recognizes that Form ATS was designed before NMS Stock ATSs operated at the level of complexity that they do today, and the equity market structure has substantially changed since Regulation ATS was adopted.<sup>163</sup> As such, the

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<sup>161</sup> See 17 CFR 240.19b-4(f).

<sup>162</sup> See supra notes 20-25 and accompanying text and infra notes 341-342 and accompanying text (discussing, in more detail, the differences in the regulatory regimes for registered national securities exchanges and ATSs, including with respect to requirements related to transparency of operations). See also 17 CFR 242.301(b)(2) (requiring ATSs to file amendments on Form ATS at least 20 days prior to implementing a material change to the operation of the ATS, and within 30 calendar days after the end of each calendar quarter to update any other information that has become inaccurate and not previously reported).

<sup>163</sup> As discussed below, the Commission preliminarily believes that information solicited on Form ATS-N would be similar to portions of what registered national securities exchange are required to publicly disclose, and thus, that disclosure of the information would not place NMS Stock ATSs at a competitive disadvantage with respect to competing trading venues. See infra Section IV.D. The Commission notes that, while some of the questions on Form ATS-N are designed to provide information about potential conflicts of interest arising from the activities of the broker-dealer operator or its affiliates and are dissimilar to information required to be disclosed by a national securities exchange, national securities exchanges must have rules that are consistent with the Exchange Act, and in particular Section 6. As discussed below, to date, national securities exchanges have implemented rules to address the potential for conflicts of interest when the national securities exchange is affiliated with a broker-dealer that is a member of the national securities exchange. See, infra, notes 367-371 and accompanying text (discussing the

Commission preliminarily believes that transparency of NMS Stock ATSS' operations will promote competition and benefit investors by informing market participants about differences between trading venues that could impact the quality of the execution of their orders.<sup>164</sup> The Commission preliminarily believes that requiring ATSS to respond to proposed Form ATS-N, which would require more detailed information about the ATSS' operations and be made available to the public on the Commission's website, would facilitate the public's understanding of NMS Stock ATSS by improving the information available to market participants, enabling them to make better decisions about where to route their orders to achieve their investing or trading objectives.

**D. Prior Comments on Operational Transparency and Regulatory Framework for NMS Stock ATSS**

As discussed in more detail below, the Commission is proposing to amend Regulation ATS to adopt Form ATS-N, which would require an NMS Stock ATS to publicly disclose detailed information about its operations and the activities of the broker-dealer operator and its affiliates. The Commission is also proposing to modify the regulatory requirements that apply to NMS Stock ATSS and qualify NMS Stock ATSS for the exemption from the definition of "exchange" under Exchange Act Rule 3a1-1(a)(2) by declaring the Form ATS-N effective or ineffective.

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Commission's concerns regarding conflicts of interest in the context of national securities exchanges).

<sup>164</sup> See *infra* Section XIII.C (discussing the Commission's preliminary belief that the proposal would help market participants make better decisions about where to route their orders, improve the efficiency of capital allocation, and execution quality, and also addressing the effect of the disclosure of proprietary information on competition).

In 2009, the Commission proposed to amend the regulatory requirements of the Exchange Act that apply to non-public trading interest in NMS stocks, including dark pools.<sup>165</sup> Among other things, the Commission proposed to substantially lower the trading volume threshold in Regulation ATS that triggers public display obligations for ATSs and to amend joint-industry plans for publicly disseminating consolidated trade data to require real-time disclosure of the identity of an ATS in the consolidated last-sale report. The Commission received four comments on its Regulation of Non-Public Interest proposal that directly relate to the amendments to Regulation ATS that the Commission is proposing today.<sup>166</sup>

Three commenters expressed the view that the Commission should address the regulatory disparity between national securities exchanges and ATSs. Senator Edward E. Kaufman expressed the view that “as trading continues to become faster and more dispersed, it is that much more difficult for regulators to perform their vital oversight and surveillance functions,” and that “the Commission should consider strengthening the regulatory requirements for becoming an Alternative Trading System or starting a new trading platform for existing market

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<sup>165</sup> See Regulation of Non-Public Trading Interest, *supra* note 123, at 62108 (proposing rules and amendment to joint-industry plans).

<sup>166</sup> See letter to Mary L. Schapiro, Chairman, Commission, from Sen. Edward E. Kaufman, United States Senate, dated August 5, 2010 (“Kaufman letter”); letters to Elizabeth M. Murphy, Secretary, Commission, from Janet M. Kissane, Senior Vice President, Legal & Corporate Secretary Office of the General Counsel, NYSE Euronext, dated February 22, 2010 (“NYSE Euronext letter #1”); from Jeffrey D. Morgan, CAE, President and CEO, National Investor Relations Institute, dated February 16, 2010 (“National Investor Relations Institute letter”); letter to the Commission, from Seth Merrin, Chief Executive Officer; Anthony Barchetto, Head of Trading Strategy; Jay Biancamo, Global Head of Marketplace; Vlad Khandros, Market Structure Analyst; Howard Meyerson, General Counsel, Liquidnet, Inc., dated December 21, 2009 (“Liquidnet letter #1”).

centers.”<sup>167</sup> Senator Kaufman further urged the Commission to “harmonize rules across all market centers to ensure exchanges and ATSS are competing on a level playing field that serves the interests of all investors.” NYSE Euronext stated that because “ATSS now represent a significant share of trading volume in NMS stocks . . . the time is ripe to move to a framework that has consistent regulatory requirements when the trading activity at issue is essentially the same.”<sup>168</sup> The National Investor Relations Institute opined that “the same regulatory oversight, market surveillance, reporting, and other investor safeguards that exist for exchanges should be in place for all trading venues to ensure maximum investor protection.”<sup>169</sup>

Liquidnet expressed the view that the Commission should require institutional brokers, including institutional ATSS, to disclose to their customers specific order handling practices and that Regulation ATS should be amended to enhance the review process of new ATSS and material changes to ATSS’ business operations.<sup>170</sup> Liquidnet stated that disclosures by institutional brokers, including institutional ATSS, to their customers should include, among other things, identification of external venues to which the broker routes orders, the process for crossing orders with other orders received by the broker, execution of orders as agent and principal, a detailed description of the operation and function of each ATS or trading desk operated by the broker, a clear and detailed description of each algorithm and order type offered by the broker, categories of participant and admission criteria for each ATS or trading desk with which the customer’s order can interact, and internal processes and policies to control

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<sup>167</sup> Kaufman letter, supra note 166, attachment at 4-5.

<sup>168</sup> NYSE Euronext letter #1, supra note 166, at 3.

<sup>169</sup> National Investor Relations Institute letter, supra note 166, at 2.

<sup>170</sup> See Liquidnet letter #1, supra note 166, at D-5-6, 11.

dissemination of the institution's order and trade information and other confidential information.<sup>171</sup> Liquidnet also suggested that the Commission amend "Regulation ATS to permit the Commission to delay the effective date of a new ATS commencing operation or of an existing ATS implementing a material business change if the Commission believes that information in the ATS filing is unclear or incomplete or raises an issue of potential non-compliance with applicable law or regulation," and expressed support for making publicly available ATS filings with the Commission.<sup>172</sup>

In 2010, the Commission issued a Concept Release that, among other things, solicited comment on whether trading centers offering undisplayed liquidity are subject to appropriate regulatory requirements for the type of business they conduct.<sup>173</sup> Specifically, the Commission asked, among other things, for comment on the following:<sup>174</sup>

- Do investors have sufficient information about dark pools to make informed decisions about whether in fact they should seek access to dark pools? Should dark pools be required to provide improved transparency on their trading services and the nature of their participants? If so, what disclosures should be required and in what manner should ATSS provide such disclosures?
- Are there any other aspects of ATS regulation that should be enhanced for dark pools or for all ATSS, including ECNs?

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<sup>171</sup> See Liquidnet letter #1, supra note 166, at D-5-6.

<sup>172</sup> Id. at D-11.

<sup>173</sup> See 2010 Equity Market Structure Release, supra note 124, at 3614.

<sup>174</sup> See id.

- Are there any ways in which Regulation ATS should be modified or supplemented to appropriately reflect the significant role of ATSS in the current market structure?

The Commission received 20 comment letters that addressed these questions as they relate to the proposal.<sup>175</sup> The 20 comment letters offered contrasting views.

Five commenters expressed support for Commission action to address the regulatory disparity between national securities exchanges and ATSS, particularly where such trading venues perform similar functions. Security Traders Association of New York noted that it has

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<sup>175</sup> See letters from Theodore R. Lazo, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated October 24, 2014 (“SIFMA letter #2”); Richie Prager, Hubert De Jesus, Supurna Vedbrat, and Joanne Medero, BlackRock, Inc., dated September 12, 2014 (“Blackrock letter”); Micah Hauptman, Consumer Federation of America, dated September 9, 2014 (“Consumer Federation of America letter”); Christopher Nagy and Dave Lauer, KOR Group LLC, dated April 4, 2014 (“KOR Group letter”); Bill Neuberger, Andrew Silverman, Paul Fitzgerald, and Sapna Patel, Morgan Stanley, dated March 7, 2011 (“Morgan Stanley letter”); Raymond M. Tierney III and Gary Stone, Bloomberg Tradebook LLC, dated June 28, 2013 (“Bloomberg Tradebook letter”); Greg Tusar, Goldman Sachs Execution & Clearing, L.P., and Matthew Lavicka, Goldman Sachs & Co., dated June 25, 2010 (“Goldman Sachs letter”); Jeffrey S. Wecker, Lime Brokerage LLC, dated May 21, 2010 (“Lime Brokerage letter”); Andrew C. Small, Scottrade, dated May 19, 2010 (“Scottrade letter”); Kimberly Unger, The Security Traders Association of New York, Inc., dated May 10, 2010 (“Security Traders Association of New York letter”); Stuart J. Kaswell, Managed Funds Association, dated May 7, 2010 (“Managed Funds Association letter”); Raymond M. Tierney III, Bloomberg L.P., dated May 7, 2010 (“Bloomberg L.P. letter”); James J. Angel, Georgetown University, McDonough School of Business, dated January 16, 2011 (“Angel letter”); Joan C. Conley, Nasdaq OMX Group, Inc., dated April 30, 2010 (“Nasdaq OMX letter”); Ann Vlcek, Securities Industry and Financial Markets Association, dated April 29, 2010 (“SIFMA letter #1”); Joseph M. Velli, BNY ConvergeEx Group, LLC, dated April 29, 2010 (“BNY CovergeEx Group letter”); O. Mason Hawkins, Richard W. Hussey, Deborah L. Craddock, Jeffrey D. Engelberg, and W. Douglas Schrank, Southeastern Asset Management, Inc., dated April 28, 2010 (“Southeastern Asset Management letter”); Janet M. Kissane, NYSE Euronext, dated April 23, 2010 (“NYSE Euronext letter #2”); David C. Cushing, Wellington Management Company, LLP, dated April 21, 2010 (“Wellington Management Company letter”); Seth Merrin, Howard Meyerson, and Vlad Khandros, Liquidnet, Inc., dated March 26, 2010 (“Liquidnet letter #2”).

“called for the harmonization of regulatory oversight and the need for similar rules across venues, including exchanges, ATSS and other liquidity sources that are connected through the Reg. NMS regulatory framework.”<sup>176</sup> Nasdaq OMX expressed the view that the “Commission has flexibility to adopt a more principles-based regulatory structure” which it could use to “level the competitive playing field between ATSS and exchanges,” and that “[i]n areas where ATSS and exchange activities overlap, differences in [regulatory] approach should persist only if there is a clear policy basis for those differences.”<sup>177</sup> NYSE Euronext opined that the “lighter regulatory oversight for ATSS puts transparent, regulated markets at a competitive disadvantage, to the potential detriment of investors” and that “now that ATSS represent a significant share of trading volume in NMS stocks, . . . the Commission should address the regulatory disparity between registered exchanges and ATSS that engage in trading activities analogous to traditional exchange trading.”<sup>178</sup> Wellington Management Company expressed the view that “regulatory requirements for types of venues should differ only to the extent the differentiated requirements are specifically designed to address clearly identifiable and compelling needs” and that “material disparities in regulatory requirements could make it difficult for exchanges to compete with ATSS and broker-dealers and could threaten their long-term survival.”<sup>179</sup> Liquidnet stated that “[t]o the extent that an exchange conducts the equivalent business function as a broker or an ATSS, regulators should ensure that levels of regulation are consistent.”<sup>180</sup>

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<sup>176</sup> Security Traders Association of New York letter, supra note 175, at 2.

<sup>177</sup> Nasdaq OMX letter, supra note 175, at 13, 16.

<sup>178</sup> NYSE Euronext letter #2, supra note 175, at 7.

<sup>179</sup> Wellington Management Company letter, supra note 175, at 3.

<sup>180</sup> Liquidnet letter #2, supra note 175, at F-7.

However, three commenters expressed the view that in order to rectify the regulatory disparity, the Commission should lessen regulatory burdens on exchanges, rather than enhance its regulation of ATSS. Goldman Sachs urged the Commission to “consider expanding the types of rule changes that exchanges . . . can propose on an immediately effective basis,” which “would help to level the playing field between exchanges and ATSS.”<sup>181</sup> Wellington Management Company opined that “the burden of regulation should be shared fairly by execution venues” and that “exchanges should be granted the ability to make certain rule changes in a manner similar to ATSS (i.e., as a notification with SEC veto authority, and not as part of a lengthy notice, comment, and approval process).”<sup>182</sup> Liquidnet stated that “regulators should not impose unnecessary burdens on ATSS and brokers, but rather should remove unnecessary regulatory burdens from exchanges, to the extent that they exist.”<sup>183</sup>

Ten commenters expressed the view that ATSS and broker-dealers should be required to provide more enhanced disclosures regarding their operations, and described specific disclosures that the Commission should require of ATSS. SIFMA stated that the Commission “should require broker-dealers to publish on their websites, on a monthly basis, a standardized disclosure report that provides an overview of key macro issues that are of interest to clients,” including, among other things, “order types supported on the broker-dealer’s ATSS (if applicable).”<sup>184</sup> Blackrock, Inc. expressed the view that although some ATSS voluntarily publish their Form ATSS filings and supplemental materials, the “particular operational features specified and degree of

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<sup>181</sup> Goldman Sachs letter, supra note 175, at 10.

<sup>182</sup> Wellington Management Company letter, supra note 175, at 3.

<sup>183</sup> Liquidnet letter #2, supra note 175, at F-7.

<sup>184</sup> SIFMA letter #2, supra note 175, at 13.

detail lack consistency from one [Form ATS] submission to another” and that “[a]dditional standardization and information are required in disclosures about ATS practices.”<sup>185</sup> Blackrock further stated that “[m]andatory ATS disclosures should include greater detail on how the platform calculates reference prices, determines order priority, matches orders between client segments, monitors execution quality, advertises orders, interacts with affiliates and is compensated by subscribers.”<sup>186</sup> The Consumer Federation of America stated that Form ATS should require ATSS to provide “critical details about an ATS’s participants, segmentation, and fee structure” because the “information will allow market participants, regulators, and third party analysts to assess whether an ATS’s terms of access and service are such that it makes sense to trade on that venue.”<sup>187</sup> The Consumer Federation of America further opined that “the Commission should undertake an exhaustive investigation of the current order types, requiring exchanges and all ATSS, including dark pools, to disclose in easily understandable terms what their purpose is, how they are used in practice, who is using them, and why they are not discriminatory or resulting in undue benefit or harm to any traders.”<sup>188</sup>

Bloomberg Tradebook LLC noted that buy-side representatives with whom it met at a workshop for members of equity trading desks of asset managers stated that although they periodically send questionnaires to their brokers regarding order handling and internalization (dark pool) matching protocols, because the buy-side representatives might not be customers of

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<sup>185</sup> Blackrock letter, supra note 175, at 4.

<sup>186</sup> Id.

<sup>187</sup> Consumer Federation of America letter, supra note 175, at 22.

<sup>188</sup> Id. at 37-38.

all ATSS, they could not assess order interaction that occurs across the market structure.<sup>189</sup> Bloomberg Tradebook also recommended that the Commission ask exchanges and ATSS to complete a questionnaire with “Yes” and “No” checkboxes that would provide an overview of each exchange’s or ATS’s operations, and which Bloomberg Tradebook suggested could be posted on the Commission’s website. Bloomberg Tradebook provided a sample questionnaire that included questions relating to, among other things, affiliations, riskless principal trades, trades effected in a proprietary capacity, sharing of orders or order information with affiliates or other trading venues and compensation for such sharing, operation of a smart order router and whether it gives preference to the exchange or ATS or an affiliate, priority rules, order types that enable customers to gain preference, and special fees or rebates which lead to a preference of one order over another.<sup>190</sup>

Goldman Sachs recommended an enhanced disclosure regime for exchanges and ATSS consisting of four components. First, exchanges and ATSS would be required to “provide descriptions of the types of functionalities that they provide, such as types of orders (e.g., flash/pinging orders, conditional orders), services (e.g., co-location, special priority), and data (e.g., depth-of-book quotations, per order information).” Second, they would “disclose the basis upon which members/subscribers access the type of order, service or data,” and “whether only a certain class of market participants has access.” Third, they would be required to disclose how commonly the functionality is used. Fourth, the exchanges and ATSS would disclose more

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<sup>189</sup> Bloomberg Tradebook letter, supra note 175, at 1.

<sup>190</sup> Id. at 2-3.

market quality statistics “so that investors and other market participants could better gauge execution quality.”<sup>191</sup>

Lime Brokerage, LLC recommended that the Commission should require “transparency around pricing, access criteria and membership of dark pools.”<sup>192</sup> Managed Funds Association stated that “as long as co-location is available to investors, traders and larger brokers on an equal basis, the secondary market for such services to smaller customers from their brokers should be competitive and thus, fairly priced,” and therefore, “we believe market centers should disclose if they or third parties offer co-location services on a priority basis other than first available.”<sup>193</sup>

SIFMA stated its belief that “added disclosure about co-location and other market access arrangements would be beneficial to market participants,” and that “[s]uch disclosure might describe standard, high speed, co-location, or other means by which members may access an exchange or ATS, and provide market participants with details regarding the categories of market participants that use each means of access, the data capacity associated with each arrangement, and the quotation and transaction volume attributable to each arrangement.”<sup>194</sup>

Southeastern Asset Management, Inc. commented that brokers and trading venues should disclose to investors information such as payments, rebates, and fees related to execution venues, venue rankings by routing brokers and routing venues, and the inputs that create the routing rankings, and the transparency of customer specific order routing and execution available to the

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<sup>191</sup> Goldman Sachs letter, supra note 175, at 9-10.

<sup>192</sup> Lime Brokerage letter, supra note 175, at 7.

<sup>193</sup> Managed Funds Association letter, supra note 175, at 27.

<sup>194</sup> SIFMA letter #1, supra note 175, at 7.

specific customer.<sup>195</sup> Liquidnet recommended that institutional ATSS make similar disclosures to those it recommended when commenting on the Regulation of Non-Public Interest proposing rules and amendment to joint-industry plans.<sup>196</sup>

In addition to the ten commenters that provided specific Form ATS disclosure recommendations, one commenter provided some examples of customer questions and requests specific to dark pools that it received. Such questions and requests related to, among other things, whether the commenter's dark pool is truly dark, categorization or tagging of order flow, whether participants may opt out of or into interaction with certain flow, proprietary orders interaction with the dark pool, priority rules, requests to exclude certain types of venues for routing of orders, maintenance of confidential trading information, use of direct market data feeds by the dark pool's servers and algorithmic strategies, and co-location of servers and algorithmic strategies to exchange and ATS servers.<sup>197</sup> The commenter also provided some sample questions for its clients to ask of their dark pool providers. These included questions relating to the dark pools methods of access, client/subscriber base, types of orders permitted, matching of dark pool orders at the NBBO, price improvement, interaction of the dark pool's principal and proprietary orders with client orders on the dark pool, categorization or tagging of

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<sup>195</sup> See Southeastern Asset Management letter, supra note 175, at 7.

<sup>196</sup> See Liquidnet letter #2, supra note 175, at F-1-F-2; see also supra note 129.

<sup>197</sup> See Morgan Stanley letter, supra note 175, at 12-14. Additionally, representatives from Morgan Stanley met with staff from the Commission's Division of Trading and Market to discuss market structure issues. During that meeting, Morgan Stanley provided, among other things, examples of frequently asked questions that it believes could be standardized to provide mandated transparency about how orders are handled on dark pools. See Memorandum from the Division of Trading and Markets regarding an October 1, 2015, meeting with representatives of Morgan Stanley, available at <https://www.sec.gov/comments/s7-02-10/s70210.shtml>.

order flow, and order types.<sup>198</sup> The commenter also included several questions that clients should ask dark pools about the sell-side broker-dealers and exchanges that the dark pools access.

In response to the questions the Commission raised in the Equity Market Structure Release, one commenter raised questions relating to the transparency of ATSS' operations. The commenter asked, among other things, whether:

- Form ATS filings provide the Commission with complete and timely information about the operation of ATSS, and whether such filings are sufficiently frequent and detailed to allow the Commission to understand planned system changes by ATSS;
- the Commission has adequate tools to respond to concerns about the operations of ATSS;
- the Commission has adequate information about the relationships between ATSS and their subscribers, including how "toxicity" ratings are assigned to subscribers, and their impact on individual subscriber's access and fees, and whether it is acceptable that ATS subscribers can assign such ratings to counterparties within and outside the ATS without disclosing objective criteria;
- the Commission has adequate information about ATS pricing, noting that but for the Rule 3a1-1 exemption from exchange registration, ATSS would be required to charge fees that are fair and not unreasonably discriminatory; and

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<sup>198</sup> See Morgan Stanley letter, supra note 175.

- the Commission receives enough information from ATSS about their access policies to make comprehensive assessment about competitive dynamics at work in the market.<sup>199</sup>

The commenter stated its belief that responding to the Commission's questions in the Equity Market Structure Release with the commenter's own responsive questions was "entirely appropriate" because the "public cannot comment on the adequacy of Form ATS filings," and therefore, "the Commission and its staff are uniquely qualified to assess whether the requirements of the Form and the content of actual submitted filings provide adequate and timely information."<sup>200</sup>

One commenter discussed a May 2009 Opinion Research Corporation survey of 284 executives from NYSE-listed companies, noting that only 17% of the executives were satisfied with the transparency of trading in their company's stock, and that 69% of the executives "indicated there is inadequate regulatory oversight of non-exchange trading venues, including dark pools."<sup>201</sup>

Five commenters expressed the view that Form ATS filings should be made publicly available. SIFMA opined that "[t]o enhance transparency and confidence, all ATSS should publish the Form ATS and make their forms available on their websites."<sup>202</sup> Blackrock stated that current and historical Form ATS filings for active ATSS "should be made immediately available to the public, subject to appropriate redaction of confidential information," noting that

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<sup>199</sup> See Nasdaq OMX letter, supra note 175, at 14-16.

<sup>200</sup> Id. at 16.

<sup>201</sup> NYSE Euronext letter #2, supra note 175, at 7.

<sup>202</sup> SIFMA letter #2, supra note 175, at 13.

some ATS operators “have already displayed exemplary transparency by voluntarily publishing their Form ATS filings and supplemental materials.”<sup>203</sup> The Consumer Federation of America stated its support for requiring all ATSs, including dark pools, to publicly disclose their Forms ATS “so that the public can see how these venues operate.”<sup>204</sup> KOR Group LLC opined that the fact that “ATS filings are hidden from the public while the burden is on SROs to file publicly . . . does not serve the public interest in any way, and makes it easy for media and others to sensationalize and demonize what is occurring in this part of the market,” further opining that there “should not be any reasoned argument against” making Form ATS publicly available.<sup>205</sup> Goldman Sachs recommended disclosing Form ATS publicly because “[s]uch disclosure would provide investors with useful information regarding the business practices of ATSs,” and supported a requirement for “ATSs to provide public notice of material changes to their business practices,” but also stated its opposition to “any requirement that ATSs disclose information about their matching algorithms or the nature of their subscribers” because such disclosure “could result in information leakage that would detrimentally impact liquidity.”<sup>206</sup> James J. Angel commented that Form ATS should be publicly available on the Commission’s Electronic Data Gathering, Analysis, and Retrieval System (“EDGAR”).<sup>207</sup> As it had done when commenting on the Regulation of Non-Public Interest proposing rules and amendment to joint-

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<sup>203</sup> Blackrock letter, supra note 175, at 4.

<sup>204</sup> Consumer Federation of America letter, supra note 175, at 22.

<sup>205</sup> KOR Group letter, supra note 175, at 12.

<sup>206</sup> Goldman Sachs letter, supra note 175, at 10.

<sup>207</sup> See Angel letter, supra note 175, at 13.

industry plans,<sup>208</sup> Liquidnet recommended that ATS filings with the Commission be made publicly available.<sup>209</sup>

Three commenters expressed their opposition to enhanced regulation of ATSs. Scottrade, Inc. stated it believed that ATSs had “brought innovation and better execution quality to the equity markets,” and that it “would not be in favor of additional regulation that would reduce competition, raise barriers to entry for ATSs or force orders to be routed to specific destinations.”<sup>210</sup> Bloomberg L.P. stated that it had “heard exchanges argue it would be in the interest of the exchanges to regulate ATSs more aggressively,” but that it had “not seen evidence why that which is in the exchanges’ interest is necessarily in the public interest,” and suggested that the Commission should “look to investors’ needs,” which Bloomberg L.P. thought “do not . . . justify increasing the regulatory burdens on alternative trading systems.”<sup>211</sup> BNY ConvergEx Group stated its belief that “the current system of ATS regulation works well and structural changes are not necessary,” and that because “[d]ark ATSs market their services to institutional customers and prospective customers on a continuous basis . . . institutions know full well what types of customers each ATS caters to and the services they offer.”<sup>212</sup> BNY ConvergEx Group acknowledged that “some retail investors may not understand precisely how dark ATSs operate,” but opined that “[a]ny perceived lack of information for retail investors about an ATS’s trading services would only become an issue if the ATS was to become subject to the Fair Access

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<sup>208</sup> See Liquidnet letter #1 supra note 166.

<sup>209</sup> See Liquidnet letter #2, supra note 175, at F-8.

<sup>210</sup> Scottrade letter, supra note 175, at 4.

<sup>211</sup> Bloomberg L.P. letter, supra note 175, at 4-5.

<sup>212</sup> BNY ConvergEx Group letter, supra note 175, at 18, 21.

provisions of Regulation ATS,” and that “because retail investors are unlikely to pass the objective credit and other financial standards that would be required under a Fair Access regime to become subscribers of the ATS, this may not be a real issue.”<sup>213</sup>

The Commission received two comment letters on its Market Structure website relevant to the Commission’s proposal to amend Regulation ATS.<sup>214</sup>

Blackrock submitted the same comment letter to the Market Structure website that it submitted with respect to the 2010 Equity Market Structure Release.<sup>215</sup> Citadel expressed the view that “dark pools should be subject to increased transparency,” and that “ATS operational information and filings should be publicly available.”<sup>216</sup>

The Commission has considered these comments, and, for the reasons set forth throughout this release, is proposing the amendments to Regulation ATS and Exchange Act Rule 3a1-1 as described herein.

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<sup>213</sup> See id. at 21.

<sup>214</sup> See Blackrock letter, supra note 175; letter from John C. Nagel, Managing Director and Senior Deputy Counsel, Citadel LLC, dated July 21, 2014 (“Citadel letter”). See also Securities and Exchange Commission Market Structure website (“Market Structure website”), available at <http://www.sec.gov/marketstructure/>.

<sup>215</sup> See Blackrock letter, supra notes 175, 185, 186, and 203 and accompanying text.

<sup>216</sup> See Citadel letter, supra note 214, at 4.

#### IV. Proposed Amendments to Regulation ATS and Rule 3a1-1 to Heighten Regulatory Requirements for ATSs that Transact in NMS Stocks

##### A. Proposed Definition of NMS Stock ATS

The Commission is proposing to amend Rule 300 of Regulation ATS to provide for the definition of “NMS Stock ATS” in a new paragraph (k). The purpose of proposed Rule 300(k) is to specify the type of ATS that would be subject to the heightened conditions under Exchange Act Rule 3a1-1, as described further below. Proposed Rule 300(k) would define “NMS Stock ATS” to mean an “an alternative trading system, as defined in Exchange Act Rule 300(a), that facilitates transactions in NMS stocks, as defined in Exchange Act Rule 300(g).”<sup>217</sup> Rule 300(g) of Regulation ATS currently provides, and would continue to provide, that the term “NMS stock” has the meaning provided in Exchange Act Rule 600 of Regulation NMS; provided, however, that a debt or convertible debt security shall not be deemed an NMS stock for purposes of Regulation ATS.<sup>218</sup> Pursuant to Exchange Act Rule 600(b), an NMS stock is any NMS security other than an option,<sup>219</sup> and an NMS security is “any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan.”<sup>220</sup> Thus, under the

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<sup>217</sup> See proposed Rule 300(k).

<sup>218</sup> See 17 CFR 242.300(g).

<sup>219</sup> See 17 CFR 242.600(b)(47).

<sup>220</sup> See 17 CFR 242.600(b)(46). Transaction reports for securities that are listed and registered, or admitted to unlisted trading privileges on a national securities exchange, are collected, processed, and made available pursuant to the Consolidated Tape Association (“CTA”) plan (“CTA Plan”) and the OTC/UTP Plan. See, e.g., CTA Plan (dated as of October 1, 2013), available at <https://www.ctaplan.com/publicdocs/ctaplan/notifications/plans/trader-update/5929.pdf> at 34 (describing the types of securities to which the CTA plan applies).

proposed amendment to Regulation ATS, an NMS Stock ATS would include any ATS that effects transactions in securities that are listed on a national securities exchange (other than options, debt or convertible debt). In addition, to meet the definition of an NMS Stock ATS, the organization, association, person, group of persons or system must meet the definition of an alternative trading system under Rule 300(a) of Regulation ATS.<sup>221</sup>

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See also Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchange on an Unlisted Trading Privilege Basis, available at [http://web.archive.org/web/20070114023844/http://www.utpdata.com/docs/UTP\\_PlanAmendment.pdf](http://web.archive.org/web/20070114023844/http://www.utpdata.com/docs/UTP_PlanAmendment.pdf) at 2, 10-13 (“OTC/UTP Plan”) (describing the securities for which transaction information is collected and disseminated as any Nasdaq Global Market or Nasdaq Capital Market security, as defined in then-operative NASDAQ Rule 4200). Nasdaq Rule 5005(a)(26) defines Nasdaq Global Market security as: any security listed on Nasdaq that (1) satisfies all applicable requirements of the Rule 5100 and 5200 Series and meets the criteria set forth in the Rule 5400 Series; (2) is a right to purchase such security; (3) is a warrant to subscribe to such security; or (4) is an Index Warrant which meets the criteria set forth in Rule 5725(a). Nasdaq Rule 5005(a)(28) defines Nasdaq Capital Market security as: any security listed on The Nasdaq Capital Market that (1) satisfies all applicable requirements of the Rule 5100, 5200 and 5500 Series but that is not a Nasdaq Global Market security; (2) is a right to purchase such security; or (3) is a warrant to subscribe to such security.

These plans are filed with, and approved by, the Commission in accordance with the requirements of Rule 608 of Regulation NMS, and pursuant to Rule 601 of Regulation NMS, which requires every national securities exchange to “file a transaction reporting plan regarding transactions in listed equity and Nasdaq securities executed through its facilities” and every national securities association to “file a transaction reporting plan regarding transactions in listed equity and Nasdaq securities executed by its members otherwise than on a national securities exchange.”

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17 CFR 242.300(a).

As it did in the Regulation ATS Adopting Release, the Commission notes that whether the actual execution of the order takes place on the system is not a determining factor of whether a system falls under Rule 3b-16. A trading system that falls within the Commission’s functional definition of “exchange” pursuant to Rule 3b-16 will still be an “exchange,” even if it matches two trades and routes them to another system or exchange for execution. See Regulation ATS Adopting Release, supra note 7, at 70851-70852.

The Commission requests comment on the proposed definition of NMS Stock ATS. In particular, the Commission solicits comment on the following:

1. Do you believe the Commission should adopt a more limited or expansive definition of NMS Stock ATS? Why or why not? Please support your arguments.
2. Should the Commission create the NMS Stock ATS category? Why or why not? Please support your arguments.
3. Should the Commission modify its proposed definition in any way? If so, in what way and why? If not, why not? Please support your arguments.

**B. Rule 3a1-1(a)(2): Proposed Amendments to the Exemption from the Definition of “Exchange” for NMS Stock ATSs**

Exchange Act Rule 3a1-1(a) exempts from the definition of “exchange”: (1) any alternative trading system operated by a national securities association,<sup>222</sup> (2) any alternative trading system that complies with Regulation ATS,<sup>223</sup> and (3) any alternative trading system that under Rule 301(a) of Regulation ATS is not required to comply with Regulation ATS.<sup>224</sup> Most ATSS fall within the second prong of Exchange Act Rule 3a1-1 and thus, must comply with Regulation ATS to qualify for an exemption from the statutory definition of an “exchange.”

As discussed in more detail below, the Commission is now proposing to expand the conditions with which NMS Stock ATSS would be required to comply in order to use the exemption from the definition of “exchange.” To provide for these new conditions, the

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<sup>222</sup> 17 CFR 240.3a1-1(a)(1).

<sup>223</sup> 17 CFR 240.3a1-1(a)(2).

<sup>224</sup> 17 CFR 240.3a1-1(a)(3).

Commission is proposing to amend Rules 3a1-1(a)(2) and (3) to include proposed Rule 304 within the scope of Regulation ATS.<sup>225</sup> Amended Rule 3a1-1(a)(2) would condition the exemption for any ATS that meets the definition of “NMS Stock ATS” in compliance with Rules 300-303 of Regulation ATS (except Rule 301(b)(2)) and proposed Rule 304.<sup>226</sup> The Commission is proposing to amend Rule 3a1-1(a)(3) by changing the reference to Rule 303 to proposed Rule 304. This is merely a conforming change to make clear that an NMS Stock ATS that meets the requirements of Rule 301(a) is not required to comply with Regulation ATS, which would be amended to include proposed Rule 304. Rule 3a1-1(a)(1), which exempts any ATS that is operated by a national securities association, is not impacted by the amendments the Commission is proposing today.

The Commission preliminarily believes that amending the conditions to the Rule 3a1-1(a) exemption would more appropriately calibrate the level of operational transparency between registered national securities exchanges and NMS Stock ATSs, which in many regards, are functionally similar trading centers, while maintaining the regulatory framework that permits NMS Stock ATSs to decide whether to register and be regulated as broker-dealers or as national

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<sup>225</sup> In Exchange Act Rules 3a1-1(a)(2) and (3), Regulation ATS is currently defined as “17 CFR 242.300 through 242.303.” The Commission is proposing to amend these references to Regulation ATS to define Regulation ATS as “17 CFR 242.300 through 242.304.”

<sup>226</sup> See infra Section IV.C. Specifically, the Commission is proposing to amend Rule 3a1-1(a)(2) by changing the reference to Rule 303 to proposed Rule 304. Under the proposal, an NMS Stock ATS would not be required to file the reports and amendments that it is currently required to file on Form ATS pursuant to Rule 302(b)(2), unless the ATS also effects transactions in securities other than NMS stock and is not otherwise exempt. See proposed Rule 301(b)(2)(viii).

securities exchanges.<sup>227</sup> The Commission notes, as it has in other contexts,<sup>228</sup> that SRO and non-SRO markets, such as NMS Stock ATSS, are subject to different regulatory regimes, with a different mix of benefits and obligations. Pursuant to this proposal, NMS Stock ATSS would continue to be able to choose to register as national securities exchanges or as broker-dealers. The Commission is proposing, however, to increase the scope of the conditions to the exemption for the purpose of providing more transparency around the operations of NMS Stock ATSS and potential conflicts of interest resulting from the unique relationship between the broker-dealer operator and the NMS Stock ATS, as discussed further below. While questions have been raised in other contexts as to whether the broader regulatory framework for national securities exchanges and ATSS should be harmonized,<sup>229</sup> the Commission preliminarily believes that the proposals are an appropriate response to concerns about the need for transparency about the operations of NMS Stock ATSS and potential conflicts of interest resulting from the activities of their broker-dealer operators and the broker-dealer operators' affiliates. The Commission preliminarily believes that the proposals would help market participants make better informed decisions about where to route their orders for execution; the proposed disclosures would also provide the Commission with improved tools to carry out its oversight of NMS Stock ATSS. Moreover, as explained above, the Commission is concerned that market participants have limited information about the increasingly complex operations of NMS Stock ATSS,<sup>230</sup> and need more transparency on NMS Stock ATSS to fully evaluate how their orders are handled and

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<sup>227</sup> See Regulation ATS Adopting Release, supra note 7, at 70856-70857.

<sup>228</sup> See, e.g., SCI Adopting Release, supra note 17, at 72264.

<sup>229</sup> See id.

<sup>230</sup> See supra Sections III.B and C.

executed on NMS Stock ATSS. The Commission preliminarily believes that the enhanced disclosures about the operations of NMS Stock ATSS elicited by proposed Form ATS-N would provide better information about how NMS Stock ATSS operate and, thereby, enable the Commission to determine whether additional regulatory changes for either or both national securities exchanges and ATSS are necessary.

The Commission has considered the alternative of requiring different levels of disclosure among NMS Stock ATSS based on volume.<sup>231</sup> However, the Commission preliminarily believes that it is necessary and appropriate for the protection of market participants to apply the proposed heightened conditions for the Rule 3a1-1(a)(2) exemption to all NMS Stock ATSS. The Commission notes that market participants may subscribe to multiple ATSS and route orders in NMS stocks among various ATSS prior to receiving an execution. The Commission preliminarily believes that because orders in NMS stocks may be routed to any NMS Stock ATS, regardless of the volume traded on the NMS Stock ATS, all market participants would benefit from the disclosures provided pursuant to proposed Rule 304. Accordingly, the Commission believes that the proposed rules addressing greater operational transparency should apply equally to all NMS Stock ATSS.

The Commission requests comment on the scope of the proposed amendments to Rules 3a1-1(a)(2) and (3), which would apply the proposed new conditions of Rule 304 to all NMS Stock ATSS. In particular, the Commission solicits comment on the following:

4. Do you believe that the current conditions to the exemption from the definition of “exchange” for NMS Stock ATSS are appropriate in light of market developments

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<sup>231</sup> See infra Section XIII.D.4.

since Regulation ATS was adopted in 1998? Why or why not? Please support your arguments.

5. Do you believe there is sufficient transparency with respect to the operations of NMS Stock ATSS? If not, what information do you believe should be disclosed regarding the operations of an NMS Stock ATS, how frequently should it be disclosed, and why? Does the need for, and availability of, information about the operations of NMS Stock ATSS vary among market participants? If so, how? Please explain in detail.
6. Do you believe there is sufficient transparency with respect to the activities of the broker-dealer operator and its affiliates in connection with NMS Stock ATSS? If not, what information do you believe should be disclosed regarding the activities of the broker-dealer operator and its affiliates and why? Does the need for, and availability of, information about the activities of the broker-dealer operator and its affiliates vary among market participants? If so, how? Please explain in detail.
7. Should the Commission adopt the proposal to apply the requirements of proposed Rule 304 to all NMS Stock ATSS? Why or why not? Please support your arguments.
8. Do you believe that the Commission should provide any exceptions to the application of proposed Rule 304 to NMS Stock ATSS seeking to operate pursuant to the Rule 3a1-1(a)(2) exemption? Why or why not? For example, should the requirements to comply with proposed Rule 304, including the disclosure requirements of proposed Form ATS-N, only be applicable to NMS

Stock ATSS that meet certain thresholds (such dollar volume, trading volume, or number of subscribers)? If so, what should the threshold be, and why? If not, why not? Please support your arguments.

9. Do you believe that the Commission should require different levels of disclosure for any proposed Form ATS-N items based on the NMS Stock ATS's volume? If so, why, what should the different thresholds be, and which items on proposed Form ATS-N should depend on an NMS Stock ATS's volume? If not, why not? Please support your arguments.

At this time, the Commission preliminarily believes that the above operational transparency conditions to the exemption to Exchange Act Rule 3a1-1(a) should only apply to NMS Stock ATSS. The Commission, however, requests comment and data on whether its preliminary view is warranted for each category of non-NMS stock ATS.

First, approximately 27 ATSS that currently have a Forms ATS on file with the Commission disclose that they exclusively trade fixed income securities, such as corporate or municipal bonds, and approximately 2 ATSS effect transactions in both fixed income securities and other securities, including NMS stocks.<sup>232</sup> Based on Commission experience, the equity markets, which are generally highly automated trading centers that are connected through routing networks, operate and execute orders at rapid speeds using a variety of order types. Unlike the complex trading centers of the equity markets, the Commission preliminarily believes that fixed income markets currently rely less on speed, automation, and electronic trading to execute orders

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<sup>232</sup> Data compiled from Forms ATS and ATS-R submitted to the Commission as of November 1, 2015.

and other trading interest,<sup>233</sup> although that may be changing in some fixed income markets such as those that trade certain government securities.<sup>234</sup> Generally, fixed income ATs offer less complex order types to their subscribers than those offered by NMS Stock ATs, sometimes restricting incoming orders to limit orders, and the execution of matched interest involves negotiation or a process. In addition, the municipal and corporate fixed income markets tend to be less liquid than the equity markets, with slower execution times and less complex routing strategies.<sup>235</sup>

Furthermore, market participants trading fixed income securities are typically not comparing transparent trading venues against non-transparent trading venues in the same manner as market participants seeking to execute NMS stock orders. Although two affiliated national securities exchanges operate electronic systems for receiving, processing, executing, and reporting bids, offers and executions in fixed income debt securities,<sup>236</sup> the Commission preliminarily believes that the majority of trading in fixed income securities occurs on the

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<sup>233</sup> See SCI Adopting Release, supra note 17, at 72270.

<sup>234</sup> See October 15 Staff Report, infra note 247 at 35-36.

<sup>235</sup> See SCI Adopting Release, supra note 17, at 72270.

<sup>236</sup> See Securities Exchange Act Release Nos. 55496 (March 20, 2007) 72 FR 14631 (March 28, 2007) (NYSE-2006-37) (approving the establishment of NYSE Bonds as an electronic order-driven matching system for debt securities, including, but not limited to corporate bonds (including convertible bonds), international bank bonds, foreign government bonds, U.S. government bonds, government agency bonds, municipal bonds, and debt-based structured products under NYSE Rule 86) and 58839 (October 23, 2008) 73 FR 64645 (October 30, 2008) (NYSEALTR-2008-03) (notice of filing and immediate effectiveness of the Exchange's proposal to relocate the Exchange's debt trading and adopt NYSE Alternext Equities Rule 86 (now NYSEMKT – Equities Rule 86) in order to facilitate trading on the system NYSE Alternext Bonds system (now NYSEMKT Bonds)).

bilateral market.<sup>237</sup> As such, ATSS that effect trades in fixed income securities primarily compete against other trading venues with limited or no operational transparency requirements or standards. By contrast, NMS Stock ATSS, which provide limited information to market participants about their operations, compete directly with national securities exchanges, which are required to publicly disclose information about their operations in the form of proposed rule changes and a public rule book. Accordingly, the Commission preliminarily believes that any proposed revisions to the disclosure requirements for fixed income ATSS under Regulation ATS should be specifically tailored to the attributes of the fixed income market and, therefore, may require different changes to the current Regulation ATS regime and Form ATS than those being proposed herein, which are in direct response to specific transparency concerns related to the operational complexities of NMS Stock ATSS and market participants' general inability to compare NMS Stock ATSS to one another and to national securities exchanges.

The Commission recognizes, however, that trading on fixed income ATSS continues to evolve as fixed income securities are increasingly being traded on ATSS and that trading is occurring in an automated manner. Furthermore, while the specific conflicts of interest that might arise on NMS Stock ATSS operated by multiservice broker dealers may not be identical to the potential conflicts of interest that might arise on a fixed income ATSS,<sup>238</sup> the current operations of fixed income ATSS may give rise to potential conflicts of interest between the non-

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<sup>237</sup> For interdealer trading for "benchmark" U.S. Treasury securities, however, trading occurs mainly on centralized electronic trading platforms using a central limit order book, namely ATSS. See October 15 Staff Report, *infra* note 247 at 11.

<sup>238</sup> For instance, the Commission preliminarily believes that non-ATS business units of broker-dealer operators of fixed income ATSS may not trade *proprietarily* on their ATSS to the same extent that *proprietarily* trading desks, or other business units, of multiservice broker-dealer operators trade on NMS Stock ATSS.

ATS operations of a broker-dealer operator, or its affiliates, and the fixed income ATS.

Accordingly, the Commission seeks comment on the following:

10. Do you believe that market participants have sufficient information about the operations of fixed income ATSs to evaluate such ATSs as potential trading venues? Why or why not? Please support your arguments.
11. Do you believe that the Commission should apply proposed Rule 304, in whole or in part, to fixed income ATSs, or some subset of fixed income ATSs? Why or why not? If proposed Rule 304 should be applied only in part to fixed income ATSs, which parts should be applied and why? What, if any, specific modifications or additions to proposed Rule 304 should be made in any application of it to fixed income ATSs? Please support your arguments.
12. Do you believe that fixed income ATSs raise the same or similar operational transparency concerns that the Commission preliminarily believes to exist for NMS Stock ATSs? Why or why not? Please support your arguments. If not, do you believe that fixed income ATSs raise other operational transparency concerns that warrant inclusion of fixed income ATSs within the scope of proposed Rule 304? Why or why not? Please support your arguments.
13. Do you believe that there are potential conflicts of interest for broker-dealer operators of fixed income ATSs, or their affiliates, that may warrant inclusion of fixed income ATSs within the scope of proposed Rule 304? Why or why not? Please support your arguments. If yes, what are those potential conflicts of interest and how do those potential conflicts of interest differ from or resemble

the potential conflicts of interest for broker-dealer operators of NMS Stock ATSS and their affiliates? Please be specific.

14. Do you believe that the current conditions to the exemption from the definition of "exchange" are appropriate for fixed income ATSS? Why or why not? Please support your arguments.
15. Do you believe that applying proposed Rule 304 to fixed income ATSS would place them at a competitive disadvantage with respect to non-ATS trading venues that trade fixed income securities and would not be subject to such disclosure requirements? Why or why not? Please support your arguments.
16. Should the Commission adopt a new form that is designed specifically to solicit information about the operations of fixed income ATSS or the operations of certain types of fixed income ATSS? If so, please explain, in detail, the information the new form should require. If not, why not? Please support your arguments. Do you believe that part or all of any new form designed specifically for fixed income ATSS should be made available to the public? Why or why not? Please support your arguments.

As noted above, the Commission recognizes that fixed income securities markets continue to evolve as fixed income securities are increasingly being traded on ATSS in an automated manner. Thus, under the current regulatory requirements, market participants generally do not have information about how fixed income ATSS operate as ATSS are not

otherwise required to publicly disclose such information<sup>239</sup> and Forms ATS filed with the Commission by fixed income ATSs are deemed confidential.

As such, the Commission is seeking public comment on whether it should make public current Forms ATS filed by fixed income ATSs. Though the solicitations on current Form ATS are not specifically tailored to fixed income ATSs like proposed Form ATS-N would be tailored to NMS Stock ATSs, market participants could use the information to assess and compare fixed income ATSs when deciding where to trade fixed income securities. The Commission is cognizant, however, that fixed income ATSs currently file Form ATS with the understanding that the Form ATS is deemed confidential and thus, a fixed income ATS may not have chosen to operate as an alternative trading system if its Form ATS filing was originally intended to be made public. In response to any change in the regulatory requirements, a fixed income ATS may change its business model and choose to curtail its activities or cease operating as an ATS.

Accordingly, the Commission seeks comment on the following:

17. Do you believe that the current Forms ATS initial operation report, or parts thereof, filed by fixed income ATSs should be made available to the public? Why or why not? Please support your arguments.
18. Do you believe that amendments to Form ATS initial operation reports, or parts thereof, filed by fixed income ATSs should be made available to the public? Why or why not? Please support your arguments.
19. Do you believe that current Form ATS is sufficient to elicit useful information about the operations of fixed income ATSs? If so, why? If not, in what ways

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<sup>239</sup> The Commission does note, however, that some ATSs may currently make voluntary public disclosures. See, e.g., *infra* note 156.

should Form ATS be modified to better inform the Commission about the operations of fixed income ATSS? Please explain in detail the manner in which Form ATS should be modified for fixed income ATSS.

20. Do you believe that fixed income ATSS may curtail or cease operations if the Commission rescinded the confidential treatment of Form ATS and made Forms ATS filed by fixed income ATSS public? Why or why not? Please support your arguments.
21. Do you believe that if fixed income ATSS curtail or cease operations in response to the Commission rescinding the confidentiality of the Form ATS, the limitation or exit of those ATSS from the fixed income market would impact the quality of the fixed income markets in any way? Why or why not? Please support your arguments.

The questions above relate to all fixed income securities, but the Commission is also interested in learning commenters' specific views about whether ATSS that effect transactions in fixed income securities that are government securities, as defined under the Exchange Act,<sup>240</sup> should be subject to increased regulation, operational transparency requirements, or both. Under Rule 301(a)(4) of Regulation ATS, an ATS that solely trades government securities and is registered as a broker-dealer or is a bank is exempt from the requirement to either register as a national securities exchange or comply with Regulation ATS.<sup>241</sup> If an ATS trades both

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<sup>240</sup> See 15 U.S.C. 78c(a)(42) (defining "government securities" as, among other things, "securities which are direct obligations of, or obligations guaranteed as to principal or interest by, the United States").

<sup>241</sup> See 17 CFR 242.301(a)(4)(i) and (ii)(A).

government securities and non-government securities – such as NMS stocks, corporate or municipal fixed income securities – it must either register as a national securities exchange or comply with Regulation ATS. However, these ATSS are not subject to several requirements under Regulation ATS with regard to their trading in government securities. First, ATSS that do not trade NMS stocks are not subject to the order display and execution access provisions under Rule 301(b)(3).<sup>242</sup> Additionally, the government securities activities of ATSS that trade both government and other securities are not subject to either the fair access provisions of Rule 301(b)(5)<sup>243</sup> or the capacity, integrity, and security of automated systems provisions under Rule 301(b)(6).<sup>244</sup>

Pursuant to the Exchange Act (particularly the provisions of the Government Securities Act of 1986, as amended<sup>245</sup>) and federal banking laws, brokers and dealers in the government securities market are regulated jointly by the Commission, the United States Department of the Treasury (“U.S. Treasury Department”), and federal banking regulators.<sup>246</sup> Recently, staff members from the U.S. Treasury Department, the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, the Commission, and the U.S. Commodity Futures Trading Commission issued a joint report about the unusually high level of volatility and

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<sup>242</sup> See supra notes 86-90 and accompanying text.

<sup>243</sup> See supra notes 92-94 and accompanying text.

<sup>244</sup> See supra notes 96-97 and accompanying text.

<sup>245</sup> See Public Law 99-571, October 28, 1986, and Public Law 103-202, December 17, 1993.

<sup>246</sup> The Government Securities Act authorized the U.S. Treasury Department to promulgate rules governing transactions in government securities by government securities brokers and dealers. See October 15 Staff Report, infra note 247, at 9. The Commission, FINRA, and federal bank regulators – in consultation with the U.S. Treasury Department – also have the authority to issue sales practice rules for the government securities secondary market. See id.

rapid round-trip in prices that occurred in the U.S. Treasury market on October 15, 2014 (the “October 15 Staff Report”).<sup>247</sup> The October 15 Staff Report discusses the conditions that contributed to the October 15, 2014 developments and key findings from the analysis of data from that day.

The October 15 Staff Report also provides an overview of the market structure, liquidity, and applicable regulations of the U.S. Treasury market, as well as the broad changes to the structure of the U.S. Treasury market that have occurred over the past two decades.<sup>248</sup> For the secondary market in cash U.S. Treasury securities (“Treasury securities”), the October 15 Staff Report explains that trading occurs: (1) in bilateral transactions via voice or a variety of electronic means; or (2) on centralized electronic trading platforms using a central limit order book.<sup>249</sup> The October 15 Staff Report notes that the structure of the U.S. Treasury market has “evolved notably in recent years” and electronic trading has become an increasingly important feature of the modern interdealer market for Treasury securities.<sup>250</sup> Like modern-day trading in NMS stocks, the majority of interdealer trading in benchmark Treasury securities,<sup>251</sup> which is the

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<sup>247</sup> See Joint Staff Report: The U.S. Treasury Market on October 15, 2014 (July 13, 2015) (the “October 15 Staff Report”), available at [http://www.treasury.gov/press-center/press-releases/Documents/Joint\\_Staff\\_Report\\_Treasury\\_10-15-2015.pdf](http://www.treasury.gov/press-center/press-releases/Documents/Joint_Staff_Report_Treasury_10-15-2015.pdf).

<sup>248</sup> See October 15 Staff Report, *supra* note 247, at 8-14, 35-44.

<sup>249</sup> See *id.* at 11.

<sup>250</sup> See *id.* at 35.

<sup>251</sup> Benchmark issues are the most recently issued nominal coupon securities. See *id.* at 11. Nominal coupon securities pay a fixed semi-annual coupon and are currently issued at original maturities of 2, 3, 5, 7, 10, and 30 years. See *id.* at 11, n.6.

most liquid type of Treasury security, currently occurs on centralized electronic trading platforms using a central limit order book, namely ATSS.<sup>252</sup>

The October 15 Staff Report notes that the growth in high-speed electronic trading has contributed to the growing presence of Principal trading firms (“PTFs”) in the Treasury market, with these firms accounting for the majority of trading and providing the vast majority of market depth.<sup>253</sup> PTFs, which have direct access to electronic trading platforms for Treasury securities, now represent more than half of the trading activity on electronic interdealer trading platforms for Treasury securities.<sup>254</sup> Similar to HFTs in the equity markets, PTFs trading on the electronically brokered interdealer market for Treasury securities often employ automated algorithmic trading strategies that rely on speed and allow the PTFs to cancel or modify existing quotes in response to perceived market activity.<sup>255</sup> Furthermore, most PTFs trading Treasury securities on electronic platforms also restrict their activities to proprietary trading and do not hold long positions.<sup>256</sup>

The October 15 Staff Report also notes that increased trading speed due to automated trading in the U.S. Treasury market has challenged the traditional risk management protocols for market participants, trading platforms, and clearing firms.<sup>257</sup> The October 15 Staff Report notes

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<sup>252</sup> See id. at 11, 35-36. The October 15 Staff Report also notes that the majority of interdealer trading of “seasoned” Treasury securities and the majority of dealer-to-customer trading is via bilateral transactions. See id. at 11, 35-36 n.31.

<sup>253</sup> See id. at 36.

<sup>254</sup> See id.

<sup>255</sup> See id. at 32, 35-36, 39.

<sup>256</sup> See id. at 38.

<sup>257</sup> See id. at 36.

that automated trading can occur at speeds that exceed the capacity of manual detection and intervention, posing a challenge to traditional risk management protocols, and forcing market participants, trading platforms, and clearing firms to develop internal risk controls and processes to manage the potential for rapidly changing market and counterparty risk exposures.<sup>258</sup>

As indicated in the October 15 Staff Report, the staff of the U.S. Treasury Department, the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, the Commission, and the U.S. Commodity Futures Trading Commission plan to continue to analyze the events of October 15, 2014 and examine changes to the U.S. Treasury market structure. The October 15 Staff Report identified four areas for further work. One of the four areas includes the continued monitoring of trading and risk management practices across the U.S. Treasury market and a review of the current regulatory requirements applicable to the government securities market and its participants.<sup>259</sup> In connection with this, the cross-agency staff expressed support for a review of the current regulatory requirements applicable to the government securities market and its participants and suggested studying the implications of a registration requirement for firms conducting certain types of automated trading in the U.S. Treasury market and for government securities trading venues.<sup>260</sup> The staff also recommended an assessment of the data available to the public and to the official sector on U.S. Treasury cash securities markets, which would include efforts to enhance public reporting on U.S. Treasury market venue policies and services.<sup>261</sup>

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<sup>258</sup> See id. at 36-37.

<sup>259</sup> See id. at 45.

<sup>260</sup> See id. at 47.

<sup>261</sup> See id. at 48.

Based on the rapid and continued evolution of the market for government securities, the Commission is seeking comment on whether as part of its continued cooperation and coordination with other regulators, it should include ATSS whose trading activity is solely in government securities within the scope of current Regulation ATS and amend Regulation ATS to provide for enhanced operational transparency for ATSS that trade government securities.<sup>262</sup>

Specifically, the Commission seeks comment on the following:

22. Do you that believe market participants have sufficient information about the operations of ATSS that effect transactions in government securities in order to evaluate such ATSS as potential trading venues? Why or why not? Please support your arguments.
23. Do you believe that the Commission should adopt amendments to Regulation ATS to remove the exemption under Rule 301(a)(4)(ii)(A) of Regulation ATS for ATSS whose trading activity is solely in government securities? Why or why not? Please support your arguments. If so, do you believe that the Commission should make public Form ATS filings or otherwise increase the transparency requirements under Regulation ATS for ATSS whose sole trading activity is in government securities? Why or why not? Please support your arguments.
24. Do you believe that the Commission should adopt amendments to Regulation ATS to enhance the transparency requirements applicable to ATSS that effect

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<sup>262</sup> Prior to adopting any changes to Regulation ATS with regard to ATSS that trade government securities, the Commission would, as appropriate, consult with and consider the views of the Secretary of the Treasury and any other appropriate regulatory agencies. See 15 U.S.C. 78o(c)(2)(E).

transactions in both government securities and non-government securities? Why or why not? If so, how? Please support your arguments.

25. Do you believe that ATSS that effect transactions in government securities raise the same operational transparency concerns that the Commission preliminarily believes to exist for NMS Stock ATSS? Why or why not? Please support your arguments. If not, do you believe that ATSS that effect transactions in government securities raise other operational transparency concerns that warrant expanding the scope of Regulation ATS to encompass ATSS whose sole trading activity is in government securities or increasing the transparency requirements for ATSS that effect transactions in both government securities and non-government securities? Why or why not? Please support your arguments.
26. Do you believe that there are potential conflicts of interest for broker-dealer operators of ATSS, or their affiliates, that effect transactions in government securities that may justify greater operational transparency for ATSS that effect transactions in government securities? Why or why not? Please support your arguments. If yes, what are those potential conflicts of interest and how do those potential conflicts of interest differ from or resemble the potential conflicts of interest for broker-dealer operators of NMS Stock ATSS and their affiliates? Please be specific.
27. Do you believe that current Form ATS is sufficient to elicit information about the operations of ATSS that effect transactions in government securities? If not, in what ways should Form ATS be modified to better inform the Commission about the operations of ATSS that effect transactions in government securities? Please

explain in detail the manner in which Form ATS should be modified. Do you believe that the current Forms ATS, or parts thereof, for ATSs that effect transactions in government securities and non-government securities should be made available to the public? Why or why not? Please support your arguments.

28. Do you believe that the Commission should adopt amendments to existing rules under Regulation ATS, including, Rules 301(b)(3) (order display and execution access), 301(b)(5) (fair access), and 301(b)(6) (capacity, integrity, and security of automated systems), to make those rules applicable to trading in government securities on ATSs? Why or why not? If so, how? Please provide support for your arguments. Should the Commission adopt amendments to Rule 301(b)(3) of Regulation ATS to require ATSs that trade government securities to report quotes and/or trade information for public dissemination after crossing certain volume thresholds in a government security? Should such information be reported only after a delay? Why or why not? Please support your arguments.
29. Do you believe that the Commission should apply proposed Rule 304, in whole or in part, to ATSs that effect transactions in government securities? Why or why not? Please support your arguments.
30. Do you believe that the Commission should adopt a new form that is specifically designed to solicit information about the operations of ATSs that effect transactions in government securities? If so, please explain, in detail, the information the new form should require from ATSs that effect transactions in government securities. If not, why not? Please support your arguments. Do you believe that any new form designed specifically for ATSs that effect transactions

in government securities should be made available to the public? Why or why not? Please support your arguments.

31. Do you believe that broker-dealers that effect transactions in government securities may modify their business models in order to need not comply with Regulation ATS in response to enhanced regulatory or operational transparency requirements for ATSS that effect transactions in government securities? Why or why not? Please support your arguments.

There are also ATSS whose activity is solely the facilitation of trading in OTC Equity Securities.<sup>263</sup> At this time, the Commission preliminarily believes that many of its specific concerns related to the current operations of NMS Stock ATSS, which proposed Rule 304 and proposed Form ATS-N seek to address directly, are not equally applicable to OTC Equity Securities ATSS. The Commission preliminarily believes that OTC Equity Securities ATSS do not currently operate with the same complexities as NMS Stock ATSS. Additionally, trading in OTC Equity Securities is almost always facilitated through ATSS, through inter-dealer quotation systems that are not ATSS,<sup>264</sup> or elsewhere in the bilateral market. Accordingly, trading in the

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<sup>263</sup> For the purposes of this analysis and request for comment, the Commission is using the term “OTC Equity Security” as it is defined in FINRA’s 6400 rule series for quoting and trading in OTC Equity Securities. FINRA defines OTC Equity Security as “any equity security that is not an ‘NMS stock’ as that term is defined in Rule 600(b)(47) of SEC Regulation NMS; provided, however, that the term ‘OTC Equity Security’ shall not include any Restricted Equity Security,” which FINRA defines as “any equity security that meets the definition of ‘restricted security’ as contained in Securities Act Rule 144(a)(3).” See FINRA Rules 6420(f), (k).

<sup>264</sup> FINRA Rule 6420 defines an interdealer quotation system as “any system of general circulation to brokers or dealers which regularly disseminates quotations of identified brokers or dealers.” See FINRA Rule 6420(c). An example of an interdealer quotation system is the OTC Bulletin Board that FINRA operates.

market for OTC Equity Securities is typically facilitated by platforms or amongst market participants that are not subject to operational transparency requirements comparable to those imposed on national securities exchanges (i.e., the self-regulatory organization rule filing process). The Commission also preliminarily believes that OTC Equity Securities ATs are evolving and, therefore, the Commission seeks comment on the following:

32. Do you believe that market participants have sufficient information about the operations of OTC Equity Securities ATs to evaluate such ATs as potential trading venues? Why or why not? Please support your arguments.
33. Do you believe that OTC Equity Securities ATs raise the same operational transparency concerns that the Commission preliminarily believes to exist for NMS Stock ATs? Why or why not? Please support your arguments. If not, do you believe that OTC Equity Securities ATs raise other operational transparency concerns that warrant inclusion of OTC Equity Securities ATs within the scope of proposed Rule 304? Why or why not? Please support your arguments.
34. Do you believe that there are potential conflicts of interest for broker-dealer operators of ATs, and their affiliates, that facilitate transactions in OTC Equity Securities that may justify greater operational transparency for OTC Equity Securities ATs? Why or why not? Please support your arguments. If yes, what are those potential conflicts of interest and how do those potential conflicts of interest differ from or resemble the potential conflicts of interest for broker-dealer operators of NMS Stock ATs and their affiliates? Please be specific.

35. Do you believe that the Commission should apply proposed Rule 304, in whole or in part, to OTC Equity Securities ATSS? Why or why not? Please support your arguments.
36. Do you believe that applying proposed Rule 304 to OTC Equity Securities ATSS would place them at a competitive disadvantage with respect to other trading venues that facilitate transactions in OTC Equity Securities in the bilateral market, which would not be subject to such disclosure requirements? Why or why not? Please support your arguments.
37. Do you believe that current Form ATS is sufficient to elicit relevant information about the operations of OTC Equity Securities ATSS? If so, why? If not, in what ways should Form ATS be modified to better inform the Commission about the operations of OTC Equity Securities ATSS? Please explain in detail the manner in which Form ATS could be modified. Do you believe that the current filed Forms ATS, or parts thereof, for OTC Equity Securities ATSS should be made available to the public? Why or why not? Please support your arguments.
38. Do you believe that the Commission should adopt a new form that is designed specifically for OTC Equity Securities ATSS to promote operational transparency of such ATSS? If so, please explain, in detail, the information the new form should require. If not, why not? Please support your arguments. Do you believe that any new form designed specifically for OTC Equity Securities ATSS should be made available to the public? Why or why not? Please support your arguments.

Additionally, the Commission notes that there are active ATSS that trade in securities other than NMS stocks, fixed income securities, or OTC Equity Securities.<sup>265</sup> For example, an ATS might help match orders for options contracts or facilitate trades in cooperative interests or membership units in limited liability companies. At this time, the Commission does not believe that these ATSS raise the same operational transparency concerns as NMS Stock ATSS. The products traded on these ATSS are not traded on national securities exchanges and, therefore, these ATSS are not competing against platforms with greater transparency requirements. Furthermore, the Commission preliminarily believes that ATSS that trade in securities other than NMS stocks, fixed income securities, or OTC Equity Securities do not currently operate with the same complexities as NMS Stock ATSS. For such ATSS, however, the Commission seeks comment on the following:

39. Do you believe that market participants have sufficient information about the operations of ATSS that effect or facilitate transactions in securities other than NMS stocks, fixed income securities, or OTC Equity Securities as potential trading venues? Why or why not? Please support your arguments.
40. Do you believe that ATSS that effect or facilitate transactions in securities other than NMS stocks, fixed income securities, or OTC Equity Securities raise the same operational transparency concerns that the Commission preliminarily believes to exist for NMS Stock ATSS? Why or why not? Please support your arguments.

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<sup>265</sup> The Commission notes that, based on information provided on Forms ATS and ATS-R as of November 1, 2015, 5 ATSS may trade such securities.

41. Do you believe that there are potential conflicts of interest for broker-dealer operators of ATSS, and their affiliates, that effect or facilitate transactions in securities other than NMS stocks, fixed income securities, or OTC Equity Securities that may justify greater operational transparency for ATSS that effect or facilitate transactions in securities other than NMS stocks, fixed income securities, or OTC Equity Securities? Why or why not? Please support your arguments. If yes, what are those potential conflicts of interest and how do those potential conflicts of interest differ from or resemble the potential conflicts of interest for broker-dealer operators of NMS Stock ATSS and their affiliates? Please be specific.
42. Do you believe that the Commission should apply proposed Rule 304, in whole or in part, to ATSS that effect or facilitate transactions in securities other than NMS stocks, fixed income securities, or OTC Equity Securities? Why or why not? Please support your arguments. If so, please explain the types of ATSS to which proposed Rule 304 should apply and why. If not, why not? Please support your arguments.
43. Do you believe that Form ATS is sufficient to elicit useful information about the operations of ATSS that effect or facilitate transactions in securities other than NMS stocks, fixed income securities, or OTC Equity Securities? If so, why? If not, in what ways should Form ATS be modified to better inform the Commission about the operations of ATSS that effect or facilitate transactions in securities other than NMS stocks, fixed income securities, or OTC Equity Securities? Please explain in detail the manner in which Form ATS could be modified. Do

you believe that current filed Forms ATS, or parts thereof, for ATSs that effect or facilitate transactions in securities other than NMS stocks, fixed income securities, or OTC Equity Securities should be made available to the public? Why or why not? Please support your arguments.

44. Do you believe that the Commission should adopt a new form specifically designed for ATSs that effect or facilitate transactions in securities other than NMS stocks, fixed income securities, or OTC Equity Securities in order to promote operational transparency of such ATSs? If so, please explain, in detail, the information the new form should elicit from ATSs that effect or facilitate transactions in such securities. If not, why not? Please support your arguments. Do you believe that any new form designed specifically for ATSs that effect or facilitate transactions in securities other than NMS stocks, fixed income securities, or OTC Equity Securities should be made available to the public? Why or why not? Please support your arguments.

### **C. Proposed Rule 304: Enhanced Filing Requirements for NMS Stock ATSs**

#### **1. Application of Existing Requirements to NMS Stock ATSs**

Proposed Rule 304(a) would require that, unless not required to comply with Regulation ATS pursuant to Rule 301(a) of Regulation ATS, an NMS Stock ATS must comply with Rules 300-304 of Regulation ATS (except Rule 301(b)(2), as discussed in Section IV.C.2 below) to be exempt from the definition of an exchange pursuant to Rule 3a1-1(a)(2).<sup>266</sup> The Commission is

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<sup>266</sup> As discussed above, the Commission is proposing to amend Rule 3a1-1(a) to provide for modified conditions to the exemption set forth in proposed Rule 304. See supra Section IV.B.

not proposing to change Rule 301(a) as part of this proposal, but is simply making clear that Rule 301(a) continues to apply to NMS Stock ATSS, unless otherwise exempt.<sup>267</sup> Thus, NMS Stock ATSS would still be required to comply with the existing requirements of Rules 300-303 of Regulation ATS, and would additionally be required to comply with proposed Rule 304.

The Commission also notes that the requirements of Rule 301(b) (except Rule 301(b)(2)) of Regulation ATS<sup>268</sup> would continue to apply to NMS Stock ATSS. As discussed above, Rule 301(b) sets forth the conditions with which an ATS must comply to benefit from the exemption provided by Exchange Act Rule 3a1-1(a). The Commission continues to believe that compliance by NMS Stock ATSS with the provisions of Rule 301(b) of Regulation ATS (except Rule 301(b)(2)), as amended, is a necessary and appropriate condition to the Rule 3a1-1(a)(2) exemption from the definition of exchange in that the purpose of such condition is the protection of investors.<sup>269</sup> The Commission would no longer require an NMS Stock ATS to comply with the reporting and amendment requirements of Rule 301(b)(2) because such conditions would be

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<sup>267</sup> Pursuant to Rule 301(a), certain ATSS that are subject to other appropriate regulations are not required to comply with Regulation ATS, including any ATS that is: (1) registered as an exchange under Section 6 of the Exchange Act; (2) exempt from exchange registration based on limited volume; (3) operated by a national securities association; (4) registered as a broker-dealer, under Sections 15(b) or 15C of the Exchange Act, or that is a bank, that limits its securities activities to certain instruments; or (5) exempted, conditionally or unconditionally, by Commission order, after application by such alternative trading system from one or more of the requirements of Rule 301(b). See 17 CFR 242.301(a). See also Regulation ATS Adopting Release, supra note 7, at 70859-63.

<sup>268</sup> See 17 CFR 242.301(b)(1), (b)(3)-(11).

<sup>269</sup> See, e.g., Regulation ATS Adopting Release, supra note 7, at 70856. In adopting the existing conditions in Rule 301, the Commission determined that the exemption in Rule 3a1-1 was consistent with the protection of investors because the Commission believed that investors would benefit from the conditions governing an alternative trading system, in particular Regulation ATS's enhanced transparency, market access, system integrity, and audit trail provisions. See id.

replaced with the more specific disclosure requirements of proposed Rule 304 for NMS Stock ATSS, discussed in further detail below. The Commission is also proposing to make non-substantive amendments to Rule 301(b)(2)(i) and Rule 301(b)(2)(vii)<sup>270</sup> to delete outdated references to dates for phased in compliance with Regulation ATS for ATSS that were operational as of April 21, 1999, and to update the name of the Division of Trading and Markets, respectively.<sup>271</sup>

The Commission requests comment generally on all aspects of proposed Rule 304(a).

## 2. Rule 301(b)(2) and Form ATS; ATSS That Trade in Non-NMS Stocks

The Commission is proposing Rule 301(b)(2)(viii) to provide that an NMS Stock ATS shall file the reports and amendments required by proposed Rule 304 and would not be subject to the requirements of Rule 301(b)(2). Existing Rule 301(b)(2) requires an ATS to file with the Commission a Form ATS initial operation report, amendments to the Form ATS initial operation report, and cessation of operations reports on Form ATS, all of which are “deemed confidential when filed.”<sup>272</sup> Because the Commission is proposing rules to govern the content and manner in which an NMS Stock ATS would be required to disclose information to the public and the Commission on proposed Form ATS-N, existing Rule 301(b)(2), which applies, and will continue to apply, to ATSS that do not effect transactions in NMS stocks would be duplicative of the proposed amendments.<sup>273</sup>

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<sup>270</sup> See proposed Rules 301(b)(2)(i) and (vii), respectively.

<sup>271</sup> See 17 CFR 242.301(b)(2)(i) and (vii), respectively.

<sup>272</sup> See 17 CFR 242.301(b)(2).

<sup>273</sup> See *supra* Section IV.B. (discussing the proposed conditions to the exemption in Rule 3a1-1(a) for ATSS that trade NMS stocks, as compared to the conditions for ATSS that trade other securities or that trade NMS stocks as well as other securities).

Proposed Rule 301(b)(2)(viii) would also provide that an ATS that effects transactions in both NMS stocks and non-NMS stocks would be subject to the requirements of proposed Rule 304 with respect to NMS stocks and Rule 301(b)(2) with respect to non-NMS stocks. The Commission recognizes that some existing ATSs that would meet the definition of NMS Stock ATS also transact in securities other than NMS stocks. For these ATSs to be eligible for the exemption under Rule 3a1-1(a)(2), the Commission preliminarily believes that it is not necessary to mandate compliance with the heightened transparency requirements under proposed Rule 304 with respect to their non-NMS stock operations. Based on Commission experience, these ATSs are designed so that the platform on which non-NMS stock order flow interacts and executes differs from the platform on which NMS stock order flow interacts and executes. Furthermore, as explained above, the Commission preliminarily believes that the operational transparency concerns for NMS Stock ATSs do not apply equally to the markets for non-NMS stocks.<sup>274</sup> As such, the Commission has tailored proposed Form ATS-N to address the specific operational transparency concerns raised by the current functionalities of the ATS platforms on which NMS stock order flow interacts and executes. Additionally, the Commission preliminarily believes that applying proposed Rule 304 to the non-NMS stock operations of ATSs that trade both NMS stocks and non-NMS stocks would impose unequal regulatory burdens across ATSs that transact in non-NMS stocks. Under such a rule, ATSs that trade both NMS stocks and non-NMS stocks would be required to meet the heightened standards of proposed Rule 304 to be eligible for the exemption under Rule 3a1-1(a)(2) with regard to their non-NMS stock operations, whereas ATSs that only trade non-NMS stocks would not be subject to the standards under proposed Rule 304.

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<sup>274</sup> See supra Section IV.B.

The Commission also proposes to amend Rule 301(b)(9),<sup>275</sup> which requires an ATS to report transaction volume on Form ATS-R on a quarterly basis and within 10 calendar days after it ceases operation. The Commission proposes to amend Rule 301(b)(9) to require an ATS that trades both NMS stocks and non-NMS stocks to separately report its transactions in NMS stocks on one Form ATS-R, and its transactions in non-NMS stocks on another Form ATS-R. The information filed on Form ATS-R permits the Commission to monitor trading on an ATS.<sup>276</sup> As noted above, the Commission proposes to require each ATS with both NMS stock and non-NMS stock operations to file a Form ATS-N for its NMS stock operations and a separate Form ATS for its non-NMS stock operations. Because the proposed Form ATS-N and Form ATS filings of such ATSs would describe separate functionalities – the functionalities for the trading of NMS stocks and those for the trading of non-NMS stocks, respectively – the Commission preliminarily believes that these ATSs should file a separate Form ATS-R to report the trading activity for each functionality to avoid confusion and for regulatory efficiency. Accordingly, the Commission is proposing to require that these ATSs file a Form ATS-R to report transaction volume resulting from their NMS stock operations, as disclosed on a Form ATS-N, and a separate Form ATS-R to report transaction volume resulting from their non-NMS stock operations, as disclosed on Form ATS. The Commission notes that Form ATS-R would continue to be deemed confidential.

The Commission requests comment on the proposed amendments to Rules 301(b)(2) and 301(b)(9). In particular, the Commission solicits comment on the following:

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<sup>275</sup> See 17 CFR 242.301(b)(9).

<sup>276</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70878.

45. Should the Commission require ATSS that trade both NMS stocks and non-NMS stocks to make filings on both proposed Form ATS-N, with respect to its NMS stock operations, and Form ATS, with respect to its non-NMS stock operations? Why or why not? Please support your arguments.

46. Should the Commission require ATSS that trade both NMS stocks and non-NMS stocks to file a Form ATS-R with respect to their NMS stock operations and a separate Form ATS-R with respect to their non-NMS stock operations? Why or why not? Please support your arguments.

47. Do you believe that ATSS that trade both NMS stocks and non-NMS stocks should be subject to proposed Rule 304, in whole or in part, for both their NMS stock operations and non-NMS stock operations? Why or why not? Please support your arguments.

Do you believe that ATSS that trade both NMS stocks and non-NMS stocks should be required to disclose their NMS stock and non-NMS stock operations solely on proposed Form ATS-N? If so, why, and what additional disclosures should be required on proposed Form ATS-N to reflect non-NMS stock operations? If not, why not? Please support your arguments.

**3. Proposed Rule 304(a)(1)(i) and (ii): Filing and Review of Form ATS-N**

Proposed Rule 304(a)(1)(i) would provide that no exemption from the definition of “exchange” is available to an NMS Stock ATS pursuant to Exchange Act Rule 3a1-1(a)(2) unless the NMS Stock ATS files with the Commission a Form ATS-N and the Commission

declares the Form ATS-N effective. The Commission preliminarily believes that an NMS Stock ATS that is not operating on the effective date of proposed Rule 304 should not be permitted to commence operations until the Commission has had the opportunity to assess whether the NMS Stock ATS qualifies for the Rule 3a1-1(a)(2) exemption. As discussed above,<sup>277</sup> the current requirements of the Rule 3a1-1(a)(2) exemption mandate that an ATS only provide notice of its operation on a Form ATS initial operation report 20 days prior to commencing operations.<sup>278</sup> The Commission's review of Form ATS-N would help ensure that an NMS Stock ATS's disclosures comply with the requirements of proposed Rule 304 and that a consistent level of information is made available to market participants in evaluating NMS Stock ATSs.<sup>279</sup>

Proposed Rule 304(a)(1)(i) is also designed as a transition for currently operating ATSs that meet the proposed definition of NMS Stock ATS. Proposed Rule 304(a)(1)(i) would require an existing ATS that facilitates transactions in NMS stocks and that operates pursuant to a previously filed initial operation report on Form ATS as of the effective date of proposed Rule 304 (*i.e.*, a "legacy NMS Stock ATS") to file a Form ATS-N with the Commission no later than 120 calendar days after the effective date of proposed Rule 304. In other words, the effectiveness of an existing Form ATS would not suffice for a legacy NMS Stock ATS to retain its exemption from the definition of "exchange" with respect to its Rule 3b-16 activity in NMS

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<sup>277</sup> See Section IV.B.

<sup>278</sup> 17 CFR 242.301(b)(2).

<sup>279</sup> The Commission notes, however, that Form ATS-N is intended to provide regulatory and public transparency. As such, its review of Form ATS-N will be focused on an evaluation of the completeness and accuracy of the disclosure thereon, and compliance with federal securities laws. Even if the Commission declares a Form ATS-N effective, the Commission would not be precluded from later determining that an NMS Stock ATS had violated the federal securities laws or the rules and regulations thereunder. See *infra* Section IV.CIV.8.

stocks beyond the transition period following the effectiveness of proposed Rule 304. The Commission is also proposing in Rule 304(a)(1)(i) that a legacy NMS Stock ATS may continue to operate pursuant to a previously filed initial operation report on Form ATS pending the Commission's review of the filed Form ATS-N.<sup>280</sup> This provision would allow the NMS Stock ATS to continue its current operations without disruptions to the NMS Stock ATS or its current subscribers and provide the NMS Stock ATS with sufficient time to make an orderly transition from compliance under the current Regulation ATS requirements to compliance with the proposed requirements of Rule 304. The Commission notes that during the Commission's review of the filed Form ATS-N, the NMS Stock ATS would continue to operate pursuant to its existing Form ATS initial operation report and would continue to be required to file amendments on Form ATS to provide notice of changes to the operations of its system.<sup>281</sup>

The Commission considered the alternative of allowing an existing ATS that engages in Rule 3b-16 activity in NMS stocks to retain its exemption from the definition of "exchange" by virtue of its existing Form ATS, and to require only a new NMS Stock ATS to file Form ATS-N. However, the Commission preliminarily believes that this alternative would not be appropriate as it would create a significant competitive disparity between a "new" and "legacy" NMS Stock ATS, with the latter benefitting from substantially lighter disclosure requirements. More importantly, it would perpetuate the problem of limited information being available to market participants. Nevertheless, the Commission preliminarily believes that it would be appropriate to provide existing ATSs that engage in Rule 3b-16 activity with regard to NMS stocks an

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<sup>280</sup> The NMS Stock ATS would be required to continue to comply with Regulation ATS.

<sup>281</sup> 17 CFR 242.301(b)(2)(ii)-(iv).

adjustment period after the effective date of proposed Rule 304 to file a Form ATS-N. The Commission preliminarily believes that 120 calendar days is sufficient time for a legacy NMS Stock ATS to respond to the disclosure requirements on the new Form ATS-N because an ATS that is currently operating should be knowledgeable about the operations of its system and the activities of its broker-dealer operator and its affiliates.

Proposed Rule 304(a)(1)(ii)(A) would provide that the Commission declare a Form ATS-N filed by an NMS Stock ATS operating as of the effective date of proposed Rule 304 effective or ineffective no later than 120 calendar days from filing with the Commission. Similarly, Proposed Rule 304(a)(1)(ii)(B) would provide that the Commission declare a Form ATS-N filed by an NMS Stock ATS that was not operating as of the effective date of proposed Rule 304 effective or ineffective no later than 120 calendar days from filing with the Commission. The disclosures required by proposed Form ATS-N are more comprehensive than those required on current Form ATS, particularly in terms of volume, complexity, and detail. Based on its experience over the past seventeen years of receiving and reviewing notices on Form ATS, the Commission preliminarily believes that it would receive a large amount of information provided in Form ATS-N filings. The Commission preliminarily believes that 120 calendar days would provide the Commission adequate time to carry out its oversight functions with respect to its review of Forms ATS-N filed by legacy and new NMS Stock ATSs, including its responsibilities to protect investors and maintain fair, orderly, and efficient markets.<sup>282</sup>

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<sup>282</sup> As discussed above, a legacy NMS Stock ATS would be able continue to operate pursuant to a previously filed initial operation report on Form ATS pending the Commission's review of the filed Form ATS-N.

Proposed Rule 304(a)(1)(ii)(A) would further provide a process for the Commission to extend the review period for Forms ATS-N filed by NMS Stock ATSs operating as of the effective date of proposed Rule 304: (1) an additional 120 calendar days, if the Form ATS-N is unusually lengthy or raises novel or complex issues that require additional time for review, in which case the Commission will notify the NMS Stock ATS in writing within the initial 120-day review period and will briefly describe the reason for the determination that additional time for review is required; or (2) any extended review period to which the NMS Stock ATS agrees in writing. Proposed Rule 304(a)(1)(ii)(B) would include a similar provision for NMS Stock ATSs not operating as of the effective date of proposed Rule 304, except that the Commission could extend its review period up to 90 calendar days. The proposed disclosure requirements require more detailed disclosures regarding the operations of an NMS Stock ATS than do the current requirements; thereby increasing the amount of information for the Commission to review. The Commission preliminarily believes that the additional time provided by the proposed rule is appropriate because it would allow Commission and its staff to conduct a thorough review of certain lengthy, novel, or complex Form ATS-N filings and provide sufficient opportunity to discuss the filing with the NMS Stock ATS if necessary.

#### Request for Comment

48. Do you believe the Commission should adopt a rule in which it is required to declare a Form ATS-N filed by an NMS Stock ATS effective or ineffective within 120 calendar days of filing? Do you believe this is an appropriate time frame in light of the amount and nature of information to be submitted on Form ATS-N? Why or why not? Does any experience with Exchange Act Rule 19b-4 filings by

self-regulatory organizations, either in draft or in formal submission, inform the appropriate time frame?

49. Should the Commission adopt a process to further extend the period of review under certain circumstances? If so, what circumstances and why? Please support your arguments.

50. If the Commission does not declare a Form ATS-N filing effective or ineffective within 120 calendar days from filing with the Commission, or any extension of the 120-day period pursuant to proposed Rule 304(a)(1)(ii), do you believe the Form ATS-N should be automatically deemed effective? Why or why not? Please support your arguments.

51. If the Commission does not declare a Form ATS-N filing effective or ineffective within 120 calendar days from filing with the Commission, or any extension of the 120-day period pursuant to proposed Rule 304(a)(1)(ii), do you believe the Form ATS-N should be automatically deemed ineffective? Why or why not? Please support your arguments.

**4. Proposed Rule 304(a)(1)(iii): Declarations of Effectiveness or Ineffectiveness of Form ATS-N**

Proposed Rule 304(a)(1)(iii) would provide that the Commission will declare effective a Form ATS-N if the NMS Stock ATS qualifies for the Rule 3a1-1(a)(2) exemption. Proposed Rule 304(a)(1)(iii) would also provide that the Commission will declare ineffective a Form ATS-

N if it finds, after notice and opportunity for hearing, that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors.<sup>283</sup>

Under the proposal, the Commission would use Form ATS-N to evaluate whether an entity qualifies for an exemption under Rule 3a1-1(a)(2).<sup>284</sup> For the Commission to declare a Form ATS-N effective, it would evaluate, among other things, whether the entity satisfies the definition of ATS,<sup>285</sup> and more specifically, the definition of NMS Stock ATS.<sup>286</sup> The

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<sup>283</sup> A submitted Form ATS-N that contains technical deficiencies, such as missing pages or one in which the entity does not respond to all questions, including all sub-questions, would not be complete and would be returned to the NMS Stock ATS. See also 17 CFR 240.0-3. Return of a Form ATS-N would not prejudice any decision by the Commission regarding effectiveness or ineffectiveness should the NMS Stock ATS resubmit a Form ATS-N. The Commission notes an NMS Stock ATS also can choose to withdraw a filed Form ATS-N.

<sup>284</sup> An NMS Stock ATS would also be required to comply with other requirements of Rules 300-303 of Regulation ATS (except Rule 301(b)(2)) and proposed Rule 304.

<sup>285</sup> Regulation ATS defines an ATS as any organization, association, person, group of persons, or system that constitutes a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of Exchange Act Rule 3b-16, and does not set rules governing the conduct of subscribers, other than the conduct of such subscribers' trading on such organization, association, person, group of persons, or system, or discipline subscribers under the Exchange Act other than by exclusion from trading. See 17 CFR 242.300(a).

Under Exchange Act Rule 3b-16, an organization, association, or group of persons shall be considered to constitute, maintain, or provide "a marketplace or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange," if such organization, association, or group of persons: (1) brings together the orders for securities of multiple buyers and sellers; and (2) uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade. See supra note 48 and accompanying text. See also supra Section IV.A (discussing the proposed definition of "NMS Stock ATS").

<sup>286</sup> See proposed Rule 300(k). See also supra Section IV.A (discussing the proposed definition of NMS Stock ATS).

Commission preliminarily believes that whether an entity meets the definition of “NMS Stock ATS” should be a threshold requirement for the Commission to declare a Form ATS-N effective, and therefore for the ATS to qualify for the Rule 3a1-1(a)(2) exemption. Proper classification of an entity would clearly indicate to market participants, as well as the Commission, the functions that entity performs and the regulatory framework and attendant obligations that attach to that entity.<sup>287</sup> Thus, if the proposed category of NMS Stock ATS is adopted, the Commission preliminarily believes it needs to mitigate concerns that market participants may be confused or misled about whether an entity in fact meets the definition of an NMS Stock ATS. If an entity does not meet the definition, market participants may hold false expectations about how their orders may interact or be matched with other orders or they may not fully understand whether the entity with which they are doing business is required to comply with Regulation ATS. For these reasons, the Commission preliminarily believes that it would be necessary or appropriate in the public interest, and consistent with the protection of investors, to declare ineffective a Form ATS-N if it finds, after notice and opportunity for hearing, that the Form ATS-N was filed by an entity that does not meet the functional test under Exchange Act Rule 3b-16, does not perform functions commonly performed by a stock exchange, or exercises SRO powers.<sup>288</sup> Similarly, the

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<sup>287</sup> For example, an ATS that is not an NMS Stock ATS would be subject to different conditions to be eligible for the Rule 3a1-1(a)(2) exemption. Similarly, depending on the facts and circumstances, an entity that is not an ATS may be subject to requirements as a broker-dealer, but not the conditions of Regulation ATS, or may be required to register as an exchange.

<sup>288</sup> See *supra* Section IV.A. (discussing the definition of NMS Stock ATS and the underlying definition of ATS).

The entity would not fall within the definition of an “exchange” under Section 3(a)(1) of the Exchange Act and the exemption provided in Exchange Act Rule 3a1-1 would not be applicable.

Commission preliminarily believes that it would be necessary or appropriate in the public interest, and consistent with the protection of investors, to declare ineffective a Form ATS-N if it finds, after notice and opportunity for hearing, that the Form ATS-N was filed by an entity that does not meet the proposed definition of “NMS Stock ATS.”

The Commission also preliminarily believes that it would be necessary or appropriate in the public interest, and consistent with the protection of investors, to declare ineffective a Form ATS-N if it finds, after notice and opportunity for hearing, that one or more disclosures on Form ATS-N are materially deficient with respect to their accuracy, currency, or completeness. The requirements of proposed Form ATS-N are set forth in proposed Rule 304(c)(1), which provides that an NMS Stock ATS must respond to each item on Form ATS-N, as applicable, in detail and disclose information that is accurate, current, and complete. The Commission preliminarily believes that market participants would use information disclosed on Form ATS-N to evaluate whether a particular NMS Stock ATS would be a desirable venue to which to route their orders. In addition, the Commission intends to use the information disclosed on the Form ATS-N to exercise oversight over and monitor developments of NMS Stock ATSs. Given these potential uses, the Commission preliminarily believes that it is important that Form ATS-N contain detailed disclosures that are accurate, current, and complete.<sup>289</sup>

The following non-exhaustive examples are provided to illustrate various applications of

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<sup>289</sup> Proposed Form ATS-N is designed to provide market participants and the Commission with, among other things, current information about the operations of the NMS Stock ATS and the activities of the broker-dealer operator and its affiliates. Accordingly, an NMS Stock ATS would be required to provide information on proposed Form ATS-N that reflects the operations of the NMS Stock ATS at the time its Form ATS-N is declared effective by the Commission. Any changes in the operations of the NMS Stock ATS must be disclosed by the NMS Stock ATS in a Form ATS-N Amendment.

proposed Rule 304(a)(1)(iii) that could cause the Commission to declare a Form ATS-N ineffective because it contains one or more disclosures that appear to be materially deficient.<sup>290</sup> For instance, if an NMS Stock ATS discloses an order type on Form ATS-N but does not describe the key attributes of the order type, such as time-in-force limitations that can be placed on the ability to execute the order, the treatment of unfilled portions of orders, or conditions for cancelling orders in whole or in part, the Form ATS-N would not be sufficiently detailed. Likewise, if an NMS Stock ATS generally describes some of its priority rules, but fails to describe conditions or exceptions to its priority rules, or fails to describe any priority overlays,<sup>291</sup> the Form ATS-N would lack sufficient detail. If a Form ATS-N states that the NMS Stock ATS has only one class of subscribers but the Commission or its staff learns through discussions (during the review period) with the NMS Stock ATS or otherwise that the NMS Stock ATS in fact has several classes of subscribers, or if the Form ATS-N states that two classes of subscribers are charged the same trading fees but the Commission or its staff learns through discussions with the NMS Stock ATS or otherwise that in fact one class receives more favorable fees than the other, the Form ATS-N would not be accurate. If a Form ATS-N includes inconsistent information, such as a statement in one part of the form that the entity uses private feeds to calculate the NBBO, but in another part of the form it indicates that it uses the Securities Information Processor ("SIP"), the Form ATS-N would not be accurate.

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<sup>290</sup> The Commission notes that these are some, but not necessarily all, of the types of circumstances that could result in the Commission declaring a Form ATS-N ineffective under the proposed rule.

<sup>291</sup> In other words, if the NMS Stock ATS fails to describe which order would receive priority when two or more orders are otherwise on par, such as whether customer orders receive priority in a price priority system if a customer and non-customer order are at the same price, the disclosure would not be sufficient.

The Commission preliminarily believes that it would be necessary or appropriate in the public interest, and consistent with the protection of investors, to declare ineffective a Form ATS-N if it finds, after notice and opportunity for hearing, that one or more disclosures reveals non-compliance with federal securities laws, or the rules or regulations thereunder, including Regulation ATS. The Commission notes that the responsibility for accurate, current, and complete disclosures on Form ATS-N lies with the NMS Stock ATS.<sup>292</sup> The Commission's review of Form ATS-N would focus on an evaluation of the completeness and accuracy of the disclosures, and compliance with federal securities laws, including Regulation ATS. The Commission's evaluation regarding compliance with federal securities laws would involve a "red-flag" review of the Form ATS-N disclosures for apparent non-compliance with federal securities laws, or other rules or regulations thereunder, including Regulation ATS, and would focus on the disclosures made on the Form ATS-N. For example, as a condition to the Rule 3a1-1(a)(2) exemption, Rule 301(b)(1) of Regulation ATS requires that an ATS register as a broker-dealer under Section 15 of the Exchange Act.<sup>293</sup> Section 15(b)(8) of the Exchange Act<sup>294</sup> prohibits a registered broker or dealer from effecting a transaction unless the broker or dealer is a member of a securities association registered pursuant to Section 15A of the Exchange Act<sup>295</sup> or effects transactions solely on a national securities exchange of which it is a member. Therefore, to comply with Regulation ATS, and thus qualify for the Rule 3a1-1(a)(2) exemption, an ATS

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<sup>292</sup> See *infra* Section IV.E. and accompanying discussion. Proposed Rule 304(c)(1) would require NMS Stock ATSS to respond to each item on Form ATS-N, as applicable, in detail and disclose information that is accurate, current, and complete.

<sup>293</sup> 17 CFR 242.301(b)(1).

<sup>294</sup> 15 U.S.C. 78o(b)(8).

<sup>295</sup> 15 U.S.C. 78o-3.

must become a member of an SRO. If an entity were to file a Form ATS-N before registering as a broker-dealer under Section 15 of the Exchange Act, the entity would not be in compliance with Rule 301(b)(1) of Regulation ATS.<sup>296</sup> Moreover, if the entity were to file a Form ATS-N before becoming a member of an SRO, the entity would not be in compliance with Rule 301(b)(1) of Regulation ATS because Section 15(b)(1) provides that a Commission order granting registration is not effective until the broker-dealer has become a member of a national securities association registered pursuant to Section 15A of the Exchange Act,<sup>297</sup> and the Commission's order granting broker-dealer registration would not be effective.<sup>298</sup> The Commission preliminarily believes that it would be necessary or appropriate in the public interest, and consistent with the protection of investors, to declare ineffective a Form ATS-N if it finds, after notice and opportunity for hearing, that a Form ATS-N reveals non-compliance with Regulation ATS because such non-compliance would be inconsistent with proposed Rule 304(a), which requires that an NMS Stock ATS comply with Rules 300-304 (except Rule 301(b)(2)) as a condition to the exemption from the definition of exchange pursuant to Rule 3a1-1(a)(2).<sup>299</sup> As another example, if a Form ATS-N reveals non-compliance with Rule 612 of Regulation NMS, known as the "Sub-Penny Rule," which prohibits market participants, including ATSs, from displaying, ranking, or accepting orders, quotations, or indications of interest in NMS stock

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<sup>296</sup> See 17 CFR 301(b)(1). Rule 301(b)(1) requires an ATS to register as a broker-dealer under section 15 of the Exchange Act.

<sup>297</sup> See 15 U.S.C. 78o(b)(1).

<sup>298</sup> See 17 CFR 242.301(b)(1).

<sup>299</sup> The Commission notes that determining whether an NMS Stock ATS qualifies for the exemption from the definition of "exchange" would be based on information as it appears in Form ATS-N. If the Commission were to learn of different information, that determination may change.

priced in an increment smaller than \$0.01,<sup>300</sup> the Form ATS-N would not be consistent with the proposed Rule because the NMS Stock ATS would operate in a manner that would violate the federal securities laws.

During its review, the Commission and its staff may provide comments to the entity, and may request that the entity supplement information in the Form ATS-N or revise its disclosures on Form ATS-N.<sup>301</sup> An order declaring a Form ATS-N effective would not constitute a finding that the NMS Stock ATS's operations are consistent with the Exchange Act and the rules and regulations thereunder. Rather, the declaration of effectiveness would only address the issue of whether the NMS Stock ATS has complied with the requirements of Form ATS-N and would focus on the disclosures made on the Form ATS-N. The Commission would not be precluded from later determining that an NMS Stock ATS had violated the federal securities laws or the rules and regulations thereunder.

#### Request for Comment

52. Should Form ATS-N be deemed immediately effective without Commission action? Why or why not? Please support your arguments.

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<sup>300</sup> Specifically, Rule 612(a) of Regulation NMS provides that "no national securities exchange, national securities association, alternative trading system, vendor, or broker or dealer shall display, rank, or accept from any person a bid or offer, an order, or an indication of interest in any NMS stock priced in an increment smaller than \$0.01 if that bid or offer, order, or indication of interest is priced equal to or greater than \$1.00 per share." See 17 CFR 242.612(a).

<sup>301</sup> The Commission notes, however, that Form ATS-N is intended to provide regulatory and public transparency. As such, its review of Form ATS-N will be focused on an evaluation of the completeness and accuracy of the disclosure thereon, and compliance with federal securities laws.

53. Should Form ATS-N be considered ineffective on filing with the Commission until the Commission affirmatively declares the Form ATS-N ineffective? Why or why not? Please support your arguments.
54. Should the process for making a Form ATS-N effective for a legacy NMS Stock ATS be different from the process for making a Form ATS-N effective for an NMS Stock ATS that files a Form ATS-N after the effective date of the proposed rule? Why or why not? Please support your arguments. If so, how should the processes for the two categories of NMS Stock ATSs differ?
55. Do you believe that the proposed 120 calendar days after the effective date of proposed Rule 304 is a reasonable amount of time for legacy NMS Stock ATSs to complete and file a Form ATS-N? If so, why? If not, why not, and what amount of time would be reasonable? Please support your arguments.
56. Do you believe that new NMS Stock ATSs would be at a competitive disadvantage if existing NMS Stock ATSs were not required to file a Form ATS-N? Why or why not? Please support your arguments.
57. Do you believe that the proposed 120 calendar day period from filing with the Commission is a reasonable amount of time for the Commission to declare a Form ATS-N filed by an NMS Stock ATS that was not operating as of the effective date of proposed Rule 304 effective or ineffective? Do you believe the review period would place an undue burden on the NMS Stock ATS that filed the Form ATS-N? If yes, what amount of time would be reasonable? Please support your arguments.

58. Should the Commission adopt the proposal to allow a legacy NMS Stock ATS to continue operations pursuant to an existing filed initial operation report on Form ATS pending the Commission's review of its Form ATS-N? Why or why not? Please support your arguments.
59. Do you believe that if a legacy NMS Stock ATS is allowed to continue operations during the Commission's review of its Form ATS-N the Commission should make such NMS Stock ATS's Form ATS-N publicly available upon filing? Why or why not? Please support your arguments.
60. Should the Commission permit existing NMS Stock ATSs to be exempt from the definition of "exchange" by virtue of the NMS Stock ATS's current Form ATS on file with the Commission and require only new NMS Stock ATSs to file Form ATS-N? Why or why not? Would this raise competitive concerns with respect to disparate regulatory treatment of "new" and "legacy" NMS Stock ATSs? Why or why not? Please support your arguments.
61. Do you believe that the proposed 90 calendar days for the Commission to extend the Form ATS-N review period for new NMS Stock ATSs where the Form ATS-N is unusually lengthy or raises novel or complex issues is reasonable? Do you believe it would place an undue burden on the NMS Stock ATS? If so, why, and what amount of time would be reasonable? Do you believe that the proposed 90 calendar day extension period disproportionately affects new NMS Stock ATSs? Please support your arguments.
62. Should the Commission adopt the proposal to declare ineffective a Form ATS-N if it finds, after notice and opportunity for hearing, that such action is necessary or

appropriate in the public interest, and is consistent with the protection of investors? Please support your arguments.

63. Do you believe that the Commission's examples of reasons that the Commission might declare a proposed Form ATS-N ineffective are appropriate? If yes, why? If not, why not? Please support your arguments.

64. Do you believe that the Commission should consider any other factors in determining whether a Form ATS-N should be declared effective or ineffective? If so, what are they and why? If not, why not? Please support your arguments.

65. Should the Commission require public notice and comment before declaring a Form ATS-N effective or ineffective? Why or why not? Please support your arguments.

**5. Proposed Rule 304(a)(1)(iv): Orders Regarding Form ATS-N Effectiveness**

Proposed Rule 304(a)(1)(iv) would provide that the Commission will issue an order to declare a Form ATS-N effective or ineffective. Proposed Rule 304(a)(1)(iv) would also provide that upon the effectiveness of the Form ATS-N, the NMS Stock ATS may operate pursuant to the conditions in proposed Rule 304. Proposed Rule 304(a)(1)(iv) would also provide that if the Commission declares a Form ATS-N ineffective, the NMS Stock ATS shall be prohibited from operating as an NMS Stock ATS. Proposed Rule 304(a)(1)(iv) would provide that a Form ATS-N declared ineffective would not prevent the NMS Stock ATS from subsequently filing a new Form ATS-N.

Proposed Rule 304(a)(1)(iv) is designed to provide notice to the public that the NMS Stock ATS that filed a Form ATS-N qualifies for the exemption provided under Exchange Act Rule 3a1-1(a)(2) and may commence operations, or if the NMS Stock ATS was operating

pursuant to a previously filed Form ATS, may continue to operate as an NMS Stock ATS. For an NMS Stock ATS operating before the effective date of proposed Rule 304 pursuant to a current Form ATS, the Form ATS for that NMS Stock ATS would no longer have any legal effect with respect to the regulatory status of the NMS Stock ATS upon the Commission declaring its Form ATS-N effective. As a result, the effective Form ATS-N would supersede and replace the NMS Stock ATS's previously filed Form ATS; and the NMS Stock ATS would no longer be subject to Rule 301(b)(2) of Regulation ATS and would not be required to file a Form ATS cessation of operation report because the NMS Stock ATS would continue operations under the effective Form ATS-N. Declaring a Form ATS-N ineffective would provide the public with notice that an entity that filed a Form ATS-N does not qualify for the exemption under Exchange Act Rule 3a1-1(a)(2) and would be precluded from operating as an NMS Stock ATS.

Under Proposed Rule 304(a)(1)(iv), an entity that had filed a Form ATS-N that had been declared ineffective by the Commission would be able to subsequently file a new Form ATS-N. This would allow an entity an opportunity to attempt to address any disclosure deficiencies or compliance issues that caused the first Form ATS-N to be declared ineffective.

#### Request for Comment

66. Do you believe that a Commission order declaring a Form ATS-N ineffective would have an unduly prejudicial effect on an entity when it refiles Form ATS-N, even where the Commission declares effective the refiled Form ATS-N? Why or why not? Please support your arguments.

#### **6. Proposed Rule 304(a)(2): Form ATS-N Amendments**

The Commission is proposing Rule 304(a)(2) to provide the requirements for filing a Form ATS-N Amendment, which would be a public document that would provide information

about the operations of the NMS Stock ATS and the activities of its broker-dealer operator and its affiliates. The information required to be filed on proposed Form ATS-N is designed to enable market participants to make more informed decisions about routing their orders to the NMS Stock ATS. The Commission's proposal to require such public disclosure is designed, in part, to bring operational transparency of NMS Stock ATSs more in line with the operational transparency of national securities exchanges.<sup>302</sup> Proposed Form ATS-N is also designed to provide information to the Commission that would allow it to monitor developments among NMS Stock ATSs and carry out its oversight functions of protecting investors and the public interest. Given these intended uses, the Commission believes that it is important for an NMS Stock ATS to maintain an accurate, current, and complete.

The Commission is proposing Rule 304(a)(2)(i) to require an NMS Stock ATS to amend an effective Form ATS-N in accordance with the instructions therein: (A) at least 30 calendar days prior to the date of implementation of a material change to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that are subject to disclosure on Form ATS-N; (B) within 30 calendar days after the end of each calendar quarter to correct any other information that has become inaccurate for any reason and has not been previously reported to the Commission as a Form ATS-N Amendment; or (C) promptly, to correct

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<sup>302</sup> See, e.g., *supra* notes 158-162 and accompanying text (discussing generally differences in disclosure requirements for national securities exchanges and ATSs). The Commission also notes that Rule 19b-4(m)(1) of the Exchange Act (17 CFR 240.19b-4(m)(1)), requires each SRO to post and maintain a current and complete version of its rules on its website. This requirement was designed to assure that SRO members and other interested persons have ready access to an accurate, up-to-date version of SRO rules. See Securities Exchange Act Release No. 50486 (October 5, 2004), 69 FR 60287 (October 8, 2004) (adopting amendments to Rule 19b-4 under the Act).

information in any previous disclosure on Form ATS-N, after discovery that any information filed under Rule 304(a)(1)(i) or (a)(2)(i)(A) or (B) was inaccurate or incomplete when filed.<sup>303</sup>

Proposed Rule 304(a)(2)(ii) would provide that the Commission will, by order, if it finds that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors, declare ineffective any Form ATS-N Amendment filed pursuant to Rule 304(a)(2)(i)(A)-(C) no later than 30 calendar days from filing with the Commission. If the Commission declares a Form ATS-N Amendment ineffective, the NMS Stock ATS shall be prohibited from operating pursuant to the ineffective Form ATS-N Amendment. The NMS Stock ATS could, however, continue to operate pursuant to a Form ATS-N that was previously declared effective. A Form ATS-N Amendment declared ineffective would not prevent the NMS Stock ATS from subsequently filing a new Form ATS-N Amendment that resolves the disclosure deficiency that resulted in the declaration of ineffectiveness.

**a. Proposed Rule 304(a)(2)(i)(A): Material Amendments**

Proposed Rule 304(a)(2)(i)(A) would, in part, require an NMS Stock ATS to amend an effective Form ATS-N in accordance with the instructions therein at least 30 calendar days prior to the date of implementation of a material change to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that are subject to disclosure on Form ATS-N. Proposed Rule 304(a)(2)(i)(A) is designed to provide advance notice to the Commission

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<sup>303</sup> The Commission notes that ATSS currently are required to file amendments to the disclosures describing their operations on Form ATS (see supra Section II.B describing the current requirements applicable to ATSS), and that national securities exchanges, as SROs, are required to file proposed rule changes with the Commission before implementing such changes, even if such changes are non-controversial (see generally supra note 161 and accompanying text).

and market participants of a material change to the operations of the NMS Stock ATS and the disclosures regarding the activities of the broker-dealer operator or its affiliates. The Commission notes that under current Rule 301(b)(2)(ii) of Regulation ATS, ATSs are required to file an amendment on Form ATS at least 20 calendar days prior to implementing a material change to the operation of the ATS.<sup>304</sup> The Commission is proposing to apply a longer time period of 30 days in proposed Rule 304(a)(2)(i)(A) due to the additional detail and information that would be provided in response to the solicitations on Form ATS-N as compared to Form ATS. As stated in the Regulation ATS Adopting Release, the Commission believes that requiring an ATS to provide the Commission advance notice of certain changes to its operation is a reasonable means for the Commission to carry out its market oversight and investor protection functions.<sup>305</sup> The Commission preliminarily believes that the 30 calendar day advance notice period before material changes are implemented would give the Commission the opportunity to make inquiries to clarify any questions that might arise or to take appropriate action, if appropriate, regarding problems that may impact market participants, including investors, before the NMS Stock ATS implemented the changes. Because material changes would be publicly disclosed upon filing, the 30 calendar day advance notice would also allow market participants to evaluate the changes before implementation and assess the NMS Stock

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<sup>304</sup> See 17 CFR 242.301(b)(2)(ii).

<sup>305</sup> See Regulation ATS Adopting Release, supra note 7, at 70864. The Commission also stated that “[i]f a system were only required to provide notice after it commenced operations, the Commission would have no notice of potential problems that might impact investors before the system begins to operate.” Id.

ATS as a continued, or potential, trading venue.<sup>306</sup>

The Commission preliminarily believes that a change to the operations of an NMS Stock ATS, or the disclosures regarding the activities of the broker-dealer operator and its affiliates, would be material if there is a substantial likelihood that a reasonable market participant would consider the change important when evaluating the NMS Stock ATS as a potential trading venue. When the Commission adopted Regulation ATS in 1998, it noted that ATSs “implicitly make materiality decisions in determining when to notify their subscribers of changes.”<sup>307</sup> The Commission is proposing to modify the conditions to the exemption to the definition of “exchange” under Rule 3a1-1(a)(2) for NMS Stock ATSs, which includes, among other things, the increased disclosure of information required on Form ATS-N. Because proposed Form ATS-N would be a public document, the Commission preliminarily believes that the use of this materiality standard discussed below would be appropriate as it is similar to materiality standards applied in the context of securities disclosures made pursuant to other Commission rules.<sup>308</sup>

To determine whether a change is material, and thus subject to the 30-day advance notice requirement, an NMS Stock ATS would need to consider all the relevant facts and

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<sup>306</sup> See infra Section IV.D (explaining proposed public disclosure requirements for Form ATS-N filings under proposed Rule 304(b)(2)).

<sup>307</sup> See id. at 70864.

<sup>308</sup> See, e.g., Securities Exchange Act Release No. 43154 (August 15, 2000), 65 FR 51716, 51721 (August 24, 2000) (Selective Disclosure and Insider Trading) (stating that to satisfy the materiality requirement, there must be a substantial likelihood that a fact would be viewed by the reasonable investor as having significantly altered the total mix of information made available); see also Regulation C under the Securities Act of 1933, 17 CFR 230.405 (“The term material, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered.”).

circumstances, including the reason for the change and how it might impact the NMS Stock ATS and its subscribers, as well as market participants that may be evaluating the NMS Stock ATS as a potential trading venue. Scenarios that are particularly likely to implicate a material change are (1) a broker-dealer operator or its affiliates beginning to trade on the NMS Stock ATS; (2) a change to the broker-dealer operator's policies and procedures governing the written safeguards and written procedures to protect the confidential trading information of subscribers pursuant to Rule 301(b)(10)(i) of Regulation ATS; (3) a change to the types of participants on the NMS Stock ATS; (4) the introduction or removal of a new order type on the NMS Stock ATS; (5) a change to the order interaction and priority procedures; (6) a change to the segmentation of orders and participants; (7) a change to the manner in which the NMS Stock ATS displays orders or quotes; and (8) a change of a service provider to the operations of the NMS Stock ATS that has access to subscriber confidential subscriber trading information. This list, however, is not intended to be exhaustive, and the Commission does not mean to imply that other changes to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates could not constitute a material change. Rather an NMS Stock ATS should be expected to consider the facts and circumstances of every change to determine whether advance notice is required.

#### Request for Comment

67. Do you believe that the Commission's proposal to require an NMS Stock ATS to file a Form ATS-N Amendment at least 30 calendar days before implementing a material change is reasonable? Why or why not? Please support your arguments. Do you believe that the advance notice period for material change on Form ATS-N should be shorter (e.g., 20 calendar days, as is the case on current Form ATS)

or longer (e.g., 45 calendar days)? Please support your arguments. Do you believe it would place an undue burden on the NMS Stock ATS? If so, why, and how much advance notice, if any, would be reasonable? Please support your arguments.

68. Are the enumerated scenarios each particularly likely to constitute a material change, such that the Commission and the public should be provided with 30 calendar days advance notice pursuant to proposed Rule 304(a)(2)(i)(A)? If yes, why? If not, why not? Are there any other scenarios generally likely to constitute a material change? If so, why, and what are those scenarios? Please support your arguments.
69. Do you believe that the Commission should propose separate tiers of material changes (e.g., based on the significance or number of changes) to the operations of the NMS Stock ATS or disclosures on Form ATS-N and that a different materiality analysis should be applied depending on the tier of change to the operations of the NMS Stock ATS or disclosures on Form ATS-N? Why or why not? Please support your arguments.
70. Do you believe that any types of material changes to an NMS Stock ATS should be eligible to be implemented immediately upon filing? If so, what are such scenarios (regardless of facts and circumstances)? Please support your arguments.
71. Do you believe that certain changes to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that would be subject to disclosure on Form ATS-N should always be considered material changes? Why

or why not? If so, please explain in detail those changes to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that would be subject to disclosure on Form ATS-N that should always be considered material changes.

72. Do you believe that certain changes to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates on Form ATS-N, such as order types, should be subject to Commission approval? Why or why not? If so, please identify such changes and support your argument.
73. Should the Commission require public notice and comment for determinations of ineffectiveness of Form ATS Amendments? Why or why not? Please support your arguments.
74. Do you believe that the Commission should make public on its website upon filing a Form ATS-N Amendment for a material change, as proposed? Why or why not? Please support your arguments. Do you believe that there should be a delay in when the Form ATS-N Amendment for a material change is made public? Why or why not? Please support your arguments.
75. Do you believe that making an NMS Stock ATS's Form ATS-N Amendment public upon filing would affect competition? Why or why not? Please support your arguments. If so, how?

**b. Proposed Rule 304(a)(2)(i)(B): Periodic Amendments**

Proposed Rule 304(a)(2)(i)(B) would require an NMS Stock ATS to amend an effective Form ATS-N within 30 calendar days after the end of each calendar quarter to correct any other information that has become inaccurate for any reason and has not been previously reported to

the Commission as a Form ATS-N Amendment.<sup>309</sup> The proposed rule would enable NMS Stock ATSS to update information from the preceding quarter that does not constitute a material change in the NMS Stock ATS's Form ATS-N filing.<sup>310</sup> The Commission preliminarily believes that providing a mechanism for NMS Stock ATSS to disclose changes to their operations or to update information that does not constitute a material change within 30 calendar days after the end of each calendar quarter would tailor the reporting burden on NMS Stock ATSS to the degree of significance of the change in a manner that does not compromise the Commission's oversight of NMS Stock ATSS or its ability to protect investors and the public interest. The Commission preliminarily believes that allowing NMS Stock ATSS to implement such changes immediately would allow NMS Stock ATSS to make periodic changes to their operations without delay, while at the same time provide disclosure about those changes to market participants and the Commission within an appropriate time frame.

Request for Comment

76. Should the Commission require NMS Stock ATSS to file a Form ATS-N Amendment for periodic changes at the end of each calendar quarter? Why or why not? Please support your arguments.

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<sup>309</sup> The Commission notes that this requirement would be substantively identical to the current requirement under Rule 301(b)(2)(iii) of Regulation ATS, which provides that: "If any information contained in the initial operation report... becomes inaccurate for any reason and has not been previously reported to the Commission as an amendment on Form ATS, the alternative trading system shall file an amendment on Form ATS correcting such information within 30 calendar days after the end of each calendar quarter in which the alternative trading system has operated." See 17 CFR 242.301(b)(2)(iii).

<sup>310</sup> That Form ATS-N Amendment, filed pursuant to proposed Rule 304(a)(2)(i)(B), would become public upon filing. See *infra* Section IV.D (explaining proposed public disclosure requirements for Form ATS-N filings under proposed Rule 304(b)(2)).

77. Do you believe that the Commission should require an NMS Stock ATS to file a Form ATS-N Amendment before implementing a periodic change? Why or why not? If so, what period of time should an NMS Stock ATS be required to wait before implementing a periodic change? Please explain in detail.
78. Do you believe that 30 calendar days after the end of each calendar quarter is a reasonable amount of time for NMS Stock ATSs to correct information that does not constitute a material change? If so, why? If not, why not, and what amount of time would be reasonable? Please support your arguments. Do you believe there are any processes the Commission should consider for correcting information on a Form ATS-N that does not constitute a material change? If so, what are such processes? Please explain in detail.
79. Do you believe that certain changes to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that would be subject to disclosure on Form ATS-N should always be considered periodic changes? Why or why not? If so, please explain in detail those changes to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that should always be considered periodic changes.
- Do you believe that the Commission should make public on its website upon filing a Form ATS-N Amendment for a periodic change? Why or why not? Please support your arguments. Do you believe that there should be a delay in when the Form ATS-N Amendment for a periodic change is made public? Why or why not? Please support your arguments.

**c. Proposed Rule 304(a)(2)(i)(C): Amendment to Correct Information on Previously Filed Form ATS-N**

Proposed Rule 304(a)(2)(i)(C) would require an NMS Stock ATS to amend an effective Form ATS-N promptly to correct information in any previous disclosure on Form ATS-N after discovery that any information filed in a Form ATS-N or Form ATS-N Amendment was inaccurate or incomplete when filed.<sup>311</sup> For example, if an NMS Stock ATS discovers that information that it previously disclosed on Form ATS-N was incorrect, such as an address or contact information, or that information it previously disclosed was incomplete, such as where the NMS Stock ATS failed to fully describe the characteristics of an order type, it would be required to promptly amend its Form ATS-N. Although the Commission recognizes that a change disclosed on a Form ATS-N Amendment that is reported pursuant to proposed Rule 304(a)(2)(i)(C) would likely be already implemented by the NMS Stock ATS, the Commission believes that it would benefit market participants to receive accurate and complete information about the NMS Stock ATS so they can use the information in deciding where to route their orders.<sup>312</sup>

Request for Comment

80. Do you believe that making amendments “promptly” is a reasonable requirement for NMS Stock ATSs to correct information that was inaccurate or incomplete

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<sup>311</sup> The Commission notes that this requirement would be substantively identical to Rule 301(b)(2)(iv) of Regulation ATS that an ATS “promptly file an amendment on Form ATS correcting information previously reported on Form ATS after discovery that any information filed” in a Form ATS initial operation report or amendment “was inaccurate when filed.” See 17 CFR 242.301(b)(2)(iv).

<sup>312</sup> That Form ATS-N Amendment, filed pursuant to proposed Rule 304(a)(2)(i)(C), would become public upon filing. See *infra* Section IV.D (explaining proposed public disclosure requirements for Form ATS-N filings under proposed Rule 304(b)(2)).

when filed? If so, why? If not, why not, and what amount of time would be reasonable? Please support your arguments.

81. Do you believe there are any other processes the Commission should consider for correcting information on Form ATS-N that was inaccurate at the time it was filed? If so, what are such processes? Please explain in detail.
82. Do you believe that the Commission's proposal to provide an NMS Stock ATS the opportunity to correct information that was inaccurate or incomplete when filed creates an unreasonable risk to market participants that an NMS Stock ATS might fail to provide accurate, current, and complete information on Form ATS-N when filing the form? Why or why not? Please support your arguments.

**d. Proposed Rule 304(a)(2)(ii): Commission Review of Form ATS-N Amendments**

The Commission is proposing Rule 304(a)(2)(ii) to provide that the Commission will, by order, if it finds that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors, declare ineffective any Form ATS-N Amendment filed pursuant to Rule 304(a)(2)(i)(A)-(C) no later than 30 calendar days from filing with the Commission.<sup>313</sup> The Commission could, for example, declare ineffective a Form ATS-N Amendment if one or more disclosures on the amended Form ATS-N are materially deficient with respect to their accuracy, currency, completeness, or fair presentation. The Commission is concerned that an NMS Stock ATS whose Form ATS-N filing was declared effective could file a

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<sup>313</sup> A filed Form ATS-N Amendment that contains technical deficiencies, such as missing pages or one in which the entity does not respond to all questions, including all sub-questions, would not be complete and would be returned to the NMS Stock ATS. See also 17 CFR 240.0-3.

Form ATS-N Amendment that contains materially deficient disclosures. The Commission is also concerned that market participants could use this information in connection with their evaluation of an NMS Stock ATS and potentially be confused or misinformed about the operations of an NMS Stock ATS. The Commission preliminarily believes that a filed Form ATS-N should contain detailed disclosures that are accurate, current, and complete and therefore is proposing a mechanism for it to declare amendments ineffective as appropriate.<sup>314</sup>

The Commission could also declare ineffective a Form ATS-N Amendment if it finds that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors, because the amendment describes a change that, under a “red flag” review, would not comply with the federal securities laws or the rules or regulations thereunder, including Regulation ATS. The Commission preliminarily believes that it would be hindered in protecting investors and maintaining fair and orderly markets if an NMS Stock ATS were allowed to implement or continue the use of a service, functionality, or procedure that does not comply with the federal securities laws or the rules or regulations thereunder, including Regulation ATS.

Under proposed Rule 304(a)(2)(ii), the Commission could declare a Form ATS-N Amendment ineffective within 30 calendar days from filing with the Commission. During its review of a Form ATS-N Amendment, the Commission and its staff may provide comments to the NMS Stock ATS, and may request that the NMS Stock ATS supplement information in the Form ATS-N Amendment or revise its disclosures on the Form ATS-N Amendment. Like the

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<sup>314</sup> See proposed Rule 304(c)(1).

Commission's review of a Form ATS-N initially filed by an entity with the Commission,<sup>315</sup> the Commission notes that its review of a Form ATS-N Amendment would focus on the disclosures made on the Form ATS-N. The Commission would not be precluded from later determining that an NMS Stock ATS had violated the federal securities laws or the rules and regulations thereunder. The Commission preliminarily believes that the 30 calendar day review period would provide the Commission with adequate time to review the Form ATS-N Amendment, discuss the changes with the broker-dealer operator as explained above and decide whether to declare the Form ATS-N Amendment ineffective.

Under proposed Rule 304(a)(2)(ii), if the Commission declares a Form ATS-N Amendment ineffective, the NMS Stock ATS would be prohibited from operating pursuant to the ineffective Form ATS-N Amendment. As discussed above, under proposed Rule 304(a)(2)(i), an NMS Stock ATS must amend its Form ATS-N at least 30 days before implementing a material change to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that are subject to disclosure on Form ATS-N, or within 30 calendar days after the end of each calendar quarter to correct any other information that has become inaccurate for any reason and has not been previously reported to the Commission as a Form ATS-N Amendment. The Commission preliminarily believes the proposed rule strikes a proper balance between, on the one hand, providing an NMS Stock ATS with the flexibility to implement a change to its operations without unnecessary delay, and on the other hand, giving the Commission time to

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<sup>315</sup> See supra Section IV.C.

adequately review Form ATS-N Amendments and carry out its oversight functions and responsibilities.<sup>316</sup>

Under proposed Rule 304(a)(1)(iv), an NMS Stock ATS that had filed a Form ATS-N Amendment that has been declared ineffective would be able to subsequently file a new Form ATS-N Amendment. This would allow an NMS Stock ATS to attempt to address any disclosure deficiencies or compliance issues that caused a Form ATS-N Amendment to be declared ineffective.

#### Request for Comment

83. Should the Commission adopt the proposal to declare ineffective any Form ATS-N Amendment if it finds that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors? Why or why not? Please support your arguments.

84. Do you believe that the Commission should affirmatively declare material amendments to Form ATS-N effective? Why or why not? If so, do you believe the Commission should declare material changes to Form ATS-N effective before

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<sup>316</sup> The Commission also preliminarily believes that the proposed process that would permit the Commission to declare Form ATS-N Amendments ineffective, even if the change disclosed in the Form ATS-N Amendments has already been implemented, would be consistent with better aligning the Commission's oversight of NMS Stock ATSs with its oversight of national securities exchanges. The Commission notes, for example, that pursuant to Section 19(b)(3)(C) of the Exchange Act, the Commission, at any time within the 60-day period beginning on the date of filing of a proposed rule change filed by a national securities exchange, "summarily may temporarily suspend the change in the rules of the [SRO] made thereby, if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of [the Act]." 15 U.S.C. 78s(b)(3)(C). As a result, the Commission may suspend a national securities exchange's proposed rule change, even if the change was eligible to be effective upon filing with the Commission.

- the NMS Stock ATS implements the material change? Why or why not? Please support your arguments.
85. Do you believe that the Commission should provide a longer time period for the Commission to review material amendments to Form ATS-N (e.g., 45 calendar days) and a shorter period of time for the NMS Stock ATS to be able to implement the material change (e.g., 10, 20, or 30 calendar days)? Why or why not? Please support your arguments. Do you believe that a longer Commission review period coupled with a shorter advance notice period would balance the burdens on an NMS Stock ATS that would be required to provide advance notice of a material change to the operations of the NMS Stock ATS with the time necessary for the Commission to review a Form ATS-N material amendment? Why or why not? Please support your arguments. Do you believe a longer Commission review period coupled with a shorter advance notice period would lead to practical challenges (e.g., confusion among market participants or difficulty to NMS Stock ATSs to unwind a change)? Please support your arguments.
86. Do you believe that a Form ATS-N Amendment should become effective by operation of rule if the Commission does not affirmatively declare it ineffective? Why or why not? Please support your arguments.
87. Do you believe that the proposed 30 calendar days from filing with the Commission is a reasonable time period for the Commission to declare a Form ATS-N Amendment ineffective? Do you believe it would place an undue burden on the NMS Stock ATS that filed the Form ATS-N Amendment? If so, why, and

what would be a reasonable amount of time? Please support your arguments. Do you believe that a longer period of time (e.g., 45 days) for the Commission to declare a Form ATS-N Amendment ineffective would be reasonable? Why or why not? Please support your arguments. Do you believe that a longer period of time would place an undue burden on the NMS Stock ATS that filed the Form ATS-N Amendment? Why or why not? Please support your arguments.

88. Do you believe the Commission should adopt a process to extend its review period for a Form ATS-N Amendment similar to the processes being proposed under proposed Rule 304(a)(1)(ii) for initial Form ATS-N filings? Why or why not? Please support your arguments. If so, how long should the extension of the review period be (e.g., 10, 15, 20, or 30 calendar days) and should the process apply to material amendments, periodic amendments, amendments to correct information in any previous Form ATS-N filing that was inaccurate or incomplete when filed, or all categories of Form ATS-N Amendments? Should the process differ depending on the category of amendment? Please be specific.
89. Should the Commission adopt the proposal that a Form ATS-N Amendment should become effective without the Commission issuing an order declaring effective the relevant Form ATS-N Amendment? Do you believe that the lack of a Commission order declaring a Form ATS-N Amendment ineffective within 30 calendar days from filing would provide an NMS Stock ATS sufficient notice that a Form ATS-N Amendment has become effective? Why or why not? Please support your arguments.

90. Do you believe that a determination of ineffectiveness of a Form ATS-N Amendment should be subject to notice and hearing, as is the case with initial determinations about Form ATS-N? Why or why not? Please support your arguments.

7. **Proposed Rule 304(a)(3): Notice of Cessation**

Proposed Rule 304(a)(3) would require an NMS Stock ATS to notice its cessation of operations on Form ATS-N at least 10 business days before the date the NMS Stock ATS ceases to operate as an NMS Stock ATS.<sup>317</sup> The notice of cessation would cause the Form ATS-N to become ineffective on the date designated by the NMS Stock ATS. Requiring an NMS Stock ATS to file a Form ATS-N notice of cessation at least 10 business days before the date the NMS Stock ATS ceases operations would provide notice to the public and the Commission that the NMS Stock ATS intends to cease operations. By making the notices of cessation public, as discussed herein,<sup>318</sup> the Commission preliminarily believes that all market participants that had routed orders to the NMS Stock ATS would be able to make arrangements to select alternative routing destinations for their orders. Regulation ATS currently requires an ATS to “promptly file a cessation of operations report on Form ATS” upon ceasing to operate.<sup>319</sup> Proposed Rule 304(a)(3) would require an NMS Stock ATS to disclose on Form ATS-N the date it will cease operating at least 10 business days before doing so. The Commission preliminarily believes that the proposal to require NMS Stock ATSs to provide notice at least 10 business days before the

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<sup>317</sup> The Commission would post a notice of cessation upon completing its review for accuracy and completion.

<sup>318</sup> See *infra* Section V (discussing public disclosure of filings on Form ATS-N, including cessation of operation reports).

<sup>319</sup> 17 CFR 242.301(b)(2)(v).

date an NMS Stock ATS ceases to operate is a reasonable period for the NMS Stock ATS to provide market participants and the Commission with notice that it intends to cease operations, as market participants would have adequate time to find and select other routing destinations for their orders.

Request for Comment

91. Should the Commission require an NMS Stock ATS to give notice that it intends to cease operations 10 business days or more before ceasing operations as an NMS Stock ATS? If so, why and how much advance notice is appropriate? If not, why not? Please support your arguments.
92. Should the Commission allow an NMS Stock ATS to notice its cessation of operations after it has ceased operations, as is currently the requirement under Regulation ATS, or at the same time that it ceases operations? If so, why and how long after the NMS Stock ATS has ceased operations? If not, why not? Please support your arguments.
93. Should the Commission create a process to revoke the exemption from Rule 3a1-1(a)(2) if the NMS Stock ATS reports no volume for two consecutive quarters, four consecutive quarters, eight consecutive quarters, or over some other time period? Why or why not? Are there any other circumstances under which the Commission should revoke the exemption if the NMS Stock ATS appears to be inactive? Please support your arguments.

**8. Proposed Rule 304(a)(4): Suspension, Limitation, or Revocation of the Exemption from the Definition of Exchange**

To rely on an exemption from the Exchange Act or the rules and regulations thereunder

granted by the Commission, the person seeking the exemption must comply with the conditions to the exemption established by the Commission. A person that fails to comply with those conditions would therefore fall outside of the scope of the exemption.<sup>320</sup> In adopting Exchange Act Rule 3a1-1(a)(2) and Regulation ATS, the Commission established conditions under which an ATS would be exempt from the definition of “exchange,” and therefore would not be required to register as a national securities exchange. Rule 3a1-1(a)(2) provides that a system that meets the criteria of Rule 3b-16 is exempt from the definition of “exchange” on condition that the system complies with Regulation ATS. As discussed above, the Commission is proposing to expand the set of conditions that an NMS Stock ATS would need to satisfy to qualify for the exemption provided under Rule 3a1-1(a)(2).

The Commission is proposing to amend Regulation ATS to include proposed Rule 304(a)(4), to provide a process for the Commission to suspend for a period not exceeding twelve months,<sup>321</sup> limit, or revoke an NMS Stock ATS’s exemption from the definition of the term exchange pursuant to Rule 3a1-1(a)(2) under certain circumstances. Regulation ATS currently does not provide a process for the Commission to suspend, limit, or revoke the exemption under which an ATS operates other than pursuant to the Commission’s general enforcement authority.<sup>322</sup> The Commission is proposing Rule 304(a)(4)(i), which would provide that the

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<sup>320</sup> See proposed Rule 304(a)(4)(iv).

<sup>321</sup> The proposed limitation on the time frame for suspension is consistent with federal securities law provisions pursuant to which the Commission may suspend the activities or registration of a regulated entity. See, e.g., Section 15(b)(4) (15 U.S.C. 78o(b)(4)) and 15B(c)(2) (15 U.S.C. 78o-4(c)(2)).

<sup>322</sup> See generally Exchange Act Section 21C (15 U.S.C. 78u-3). Use of the proposed process whereby the Commission could suspend, limit, or revoke an NMS Stock ATS’s Rule 3a1-1(a)(2) exemption would not preclude the Commission from using its general

Commission will, by order, if it finds, after notice and opportunity for hearing; that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors, suspend for a period not exceeding twelve months, limit, or revoke an NMS Stock ATS's exemption from the definition of "exchange" pursuant to Rule 3a1-1(a)(2).<sup>323</sup> Proposed Rule 304(a)(4)(ii) would make clear that if an NMS Stock ATS's exemption is suspended or revoked pursuant to proposed Rule 304(a)(4)(i), the NMS Stock ATS would be prohibited from operating pursuant to the exemption from the definition of "exchange" provided under Rule 3a1-1(a)(2); if an NMS Stock ATS's exemption is limited pursuant to proposed Rule 304(a)(4)(i), the NMS Stock ATS would be prohibited from operating in a manner inconsistent with the terms and conditions of the Commission order.

The Commission preliminarily believes that it is appropriate to provide a process by which the Commission may, by order, suspend, limit, or revoke an NMS Stock ATS's exemption from the definition of "exchange" if the NMS Stock ATS is operating in a manner such that the exemption from the definition of "exchange" for the NMS Stock ATS is not necessary or appropriate in the public interest, or consistent with the protection of investors. For example, in making a determination as to whether suspension, limitation, or revocation of an NMS Stock

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enforcement authority, or other specific enforcement authority that may be applicable such as, for example, pursuant to Section 15(b)(4) and 15(c) (15 U.S.C. 78o(b)(4); 15 U.S.C. 78o(c)). Rather, it would provide an additional means of helping to ensure that NMS Stock ATSs that no longer qualify for the Rule 3a1-1(a)(2) exemption are unable to take advantage of it. For example, if an NMS Stock ATS failed to file a Form ATS-N Amendment to disclose material changes to the operation of the NMS Stock ATS, the Commission could invoke the process to suspend, limit or revoke the NMS Stock ATS's exemption, but would not be precluded from bringing an action against the broker-dealer operator of the NMS Stock ATS for failing to comply with Rule 304(a)(2), or violating the antifraud provisions of the federal securities laws.

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See proposed Rule 304(a)(4)(i).

ATS's exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors, the Commission would take into account whether the entity no longer meets the definition of NMS Stock ATS under Rule 300(a)(k), does not comply with the conditions to the exemption (in that it fails to comply with any part of Regulation ATS, including proposed Rule 304), or otherwise violates any provision of federal securities laws.

The Commission preliminarily believes, for example, that it would be appropriate to provide for the suspension, limitation, or revocation of an NMS Stock ATS's exemption from the definition of "exchange" pursuant to Rule 3a1-1(a)(2) if the Commission finds that an NMS Stock ATS no longer meets the definition of "NMS Stock ATS."<sup>324</sup> If a system does not meet the functional test of an "exchange" under Rule 3b-16, it would not be eligible for the exemption from the definition of "exchange" pursuant to Rule 3a1-1(a)(2) as it is not an "exchange" in the first instance.<sup>325</sup> If an NMS Stock ATS no longer meets the criteria of Rule 3b-16—or meets the criteria of Rule 3b-16 but no longer effects transactions in NMS stocks—or otherwise does not meet the definition of an alternative trading system, it would not continue to be eligible for the exemption in Rule 3a1-1(a)(2) even if it had met the definition of an NMS Stock ATS at the time that the Commission declared its Form ATS-N effective. Permitting a system to operate that does not otherwise meet the definition of an NMS Stock ATS would deny investors appropriate

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<sup>324</sup> The Commission preliminarily believes that a determination as to whether to suspend, limit, or revoke an NMS Stock ATS's exemption would depend on the particular facts and circumstances; however, the Commission also preliminarily believes that revocation would be the appropriate course of action if the Commission finds that an entity no longer meets the definition of NMS Stock ATS or otherwise satisfies the criteria of the functional test under Rule 3b-16.

<sup>325</sup> See supra Section IV.A. (discussing the definition of NMS Stock ATS and the availability of the Rule 3a1-1(a)(2) exemption).

regulatory protection and could also be misleading to investors.

The Commission also preliminarily believes that it would be appropriate to provide for the suspension, limitation, or revocation of an NMS Stock ATS's exemption from the definition of exchange pursuant to Rule 3a1-1(a)(2) if, for example, the Commission finds that an NMS Stock ATS fails to comply with any part of Regulation ATS, including proposed Rule 304. As discussed in the Regulation ATS Adopting Release, instead of imposing requirements applicable to national securities exchanges, the Commission adopted enhanced regulation for ATSs that would provide more protections for investors who used the systems.<sup>326</sup> To the extent that an NMS Stock ATS fails to comply with the conditions set forth in Regulation ATS, investors would no longer be protected by the conditions of Regulation ATS or the protections afforded by the provisions of the Exchange Act and the rules thereunder that apply to national securities exchanges. For example, pursuant to proposed Rule 304(a)(4)(i), the Commission would suspend, limit, or revoke an NMS Stock ATS's exemption from the definition of "exchange" if it finds, after notice and opportunity for hearing, that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors, because the NMS Stock ATS is no longer a registered broker-dealer, which is a requirement of Regulation ATS.<sup>327</sup> The Commission would also suspend, limit, or revoke an NMS Stock ATS's exemption if the Commission finds, after notice and opportunity for hearing, that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors, because, for example, the ATS's Form ATS-N contains inaccurate or incomplete responses. Proposed Form

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<sup>326</sup> See Regulation ATS Adopting Release, supra note 7, at 70857.

<sup>327</sup> See 17 CFR 242.301(b)(1).

ATS-N would be a public reporting document that is designed to provide the Commission and market participants with information about the operations of the NMS Stock ATS and the circumstances under which the activities of the broker-dealer operator of the NMS Stock ATS and its affiliates may give rise to potential conflicts of interest. The Commission preliminarily believes that market participants would likely use the information provided on Form ATS-N to make decisions about where to route orders. The Commission is concerned that information provided on Form ATS-N that is inaccurate or incomplete could misinform or mislead market participants about the operations of the NMS Stock ATS or the activities of the broker-dealer operator, including how their orders may be handled and executed, and impact their decisions about where they should route their orders. To prevent an NMS Stock ATS from potentially misinforming or misleading market participants about the operations of the system, proposed Rule 304(a)(4) would provide a process for the Commission to suspend, limit, or revoke the NMS Stock ATS's Rule 3a1-1(a)(2) exemption.

Additionally, the Commission preliminarily believes that it would be appropriate to provide for the suspension, limitation, or revocation of an NMS Stock ATS's exemption from the definition of exchange pursuant to Rule 3a1-1(a)(2) if, for example, the Commission finds, after notice and opportunity for hearing, that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors, because that NMS Stock ATS has violated or is violating any provision of the federal securities laws. The Commission is concerned that market participants may be harmed by an NMS Stock ATS that is, for example, providing false or misleading information to market participants, and preliminarily believes that such an NMS Stock ATS should not be able to continue to operate pursuant to an exemption provided by the Commission.

Pursuant to proposed Rule 304(a)(4)(ii), an NMS Stock ATS whose exemption had been suspended or revoked would be prohibited from operating pursuant to the Rule 3a1-1(a)(2) exemption; and if an NMS Stock ATS were to continue to engage in Rule 3b-16 activity in NMS stocks without the exemption, it would be an unregistered exchange because it would no longer qualify for the exemption from the exchange definition.<sup>328</sup> If an NMS Stock ATS's exemption was limited pursuant to proposed Rule 304(a)(4)(iv), the NMS Stock ATS would be prohibited from operating in a manner otherwise inconsistent with the terms and conditions of the Commission order, and if it did operate in a manner inconsistent with the terms and conditions of the order, would risk operating as an unregistered national securities exchange. The exemption provided under Rule 3a1-1(a)(2) is conditional upon initial and ongoing compliance with Regulation ATS. The proposed process for suspending, limiting, or revoking an NMS Stock ATS's exemption, in the event the Commission finds, for example, that there is a failure to adhere to the conditions of the exemption and that suspending, limiting, or revoking the exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors, is designed to protect investors in the case of potential non-compliance by an NMS

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If the Commission revoked the exemption of an NMS Stock ATS and the NMS Stock ATS wished to continue operations, the entity could do so only if it was registered as a national securities exchange pursuant to Section 6 of the Exchange Act or was exempted by the Commission from such registration based on the limited volume of transactions effected on such exchange, or seeks another exemption. See 17 CFR 242.301(a)(1)-(2). The NMS Stock ATS would not be prohibited from filing a new Form ATS-N, pursuant to proposed Rule 304(a)(1).

An NMS Stock ATS that has had its exemption suspended or limited may, depending on the facts and circumstances, be able to file a Form ATS-N Amendment or revise its operations to come into compliance with the conditions of the exemption or the provision of any other federal securities law that may have been the basis of the Commission's findings.

Stock ATS with the conditions with which the NMS Stock ATS must adhere in order to continue to qualify for an exemption from the statutory definition of “exchange.”

The Commission also preliminarily believes that providing a process by which the Commission can determine to suspend, limit, or revoke an NMS Stock ATS’s exemption from the definition of “exchange” would provide appropriate flexibility to address the specific facts and circumstances of an NMS Stock ATS’s failure to comply with Regulation ATS or the nature of the violation of federal securities laws, and the possible harm to investors as a result of the non-compliance or violation. For example, the Commission preliminarily believes that providing a process by which the Commission could limit the exemption provided in Rule 3a1-1(a)(2) would provide flexibility to address specific disclosures or activities that are the cause of the non-compliance with Regulation ATS or that violate federal securities laws. For illustration, if the Commission found that an NMS Stock ATS implemented a material change to its operations, but failed to disclose the material change on its Form ATS-N, the Commission could determine to allow the NMS Stock ATS to continue to operate as disclosed on its Form ATS-N, but prohibit the NMS Stock ATS from engaging in the undisclosed activity until the NMS Stock ATS properly amends its Form ATS-N in accordance with proposed Rule 304(a)(2). If the Commission found that an NMS Stock ATS offered an order type that resulted in violations of the Commission’s rules restricting the acceptance and ranking of orders in impermissible sub-penny increments, the Commission could allow the NMS Stock ATS to continue to operate but prohibit the NMS Stock ATS from offering the order type, if it found that doing so was necessary or appropriate in the public interest, and consistent with the protection of investors. The Commission preliminarily believes that, depending on the facts and circumstances, it may be more appropriate in the public interest, and consistent with the protection of investors, to limit

the scope of an NMS Stock ATS's exemption, instead of revoking or suspending the exemption and causing the NMS Stock ATS to cease operations. In comparison, the Commission preliminarily believes it would be more appropriate to revoke the exemption of an NMS Stock ATS that no longer meets the definition of NMS Stock ATS or is no longer a registered broker-dealer, as these conditions are fundamental to the exemption. Additionally, the Commission preliminarily believes that it would be necessary or appropriate in the public interest, and consistent with the protection of investors, to revoke the exemption of an NMS Stock ATS if, for example, the ATS is found to be violating the antifraud provisions of the federal securities laws. Nonetheless, the entry of an order revoking an NMS Stock ATS's exemption would not prohibit the broker-dealer operator of the NMS Stock ATS from continuing its other broker-dealer operations.

The Commission is also proposing that prior to issuing an order suspending, limiting, or revoking an NMS Stock ATS's exemption pursuant to proposed Rule 304(a)(4)(i), the Commission would provide notice and opportunity for hearing to the NMS Stock ATS, and make the findings specified in proposed Rule 304(a)(4)(i) described above, that, in the Commission's opinion, the suspension, limitation or revocation is necessary or appropriate in the public interest, and is consistent with the protection of investors. The Commission preliminarily believes that the proposed process of providing an NMS Stock ATS with notice and opportunity for hearing provides the NMS Stock ATS with adequate opportunity to respond before the Commission determines that the NMS Stock ATS's exemption from the definition of "exchange" is no longer appropriate in the public interest or consistent with the protection of investors. The Commission also preliminarily believes that the possibility that the Commission may suspend, limit, or revoke an NMS Stock ATS's exemption from the definition of "exchange" would not be

unduly burdensome because an NMS Stock ATS would be given advance notice and have an opportunity to respond, and, depending on the facts and circumstances, revise its operations or disclosures on Form ATS-N to bring its operations or disclosures into compliance with Regulation ATS or federal securities laws. The Commission preliminarily believes that proposed Rule 304(a)(4) would provide the Commission with an appropriate tool, which is subject to notice and hearing safeguards, to protect the investing public and the public interest from an NMS Stock ATS that fails to comply with Regulation ATS or otherwise violates any provision of the federal securities laws.

#### Request for Comment

94. Do you believe the proposed process for the Commission to suspend, limit, or revoke an NMS Stock ATS's exemption from the definition of "exchange" is necessary or appropriate to protect investors and other market participants and maintain fair and orderly markets? Why or why not? Please support your arguments.
95. What criteria should the Commission use in deciding whether to suspend, limit, or revoke an NMS Stock ATS's exemption as proposed? Are there alternative actions or processes the Commission should consider for suspending, limiting, or revoking the exemption? Please support your arguments and provide details.
96. Should the Commission adopt the proposal to provide flexibility as to whether to suspend, limit, or revoke an NMS Stock ATS's exemption depending on the facts and circumstances and possible harm to investors? If so, why? If not, what other

criteria, if any, should the Commission use in deciding whether to suspend, limit, or revoke the exemption? Please support your arguments.

97. Do you believe there should be a maximum time frame following notice and opportunity for hearing within which the Commission should be required to act? If so, why, and what would be the appropriate time frame? If not, why not? Please support your arguments.

98. Do you believe that 12 months is the appropriate limit on the amount of time by which the Commission could suspend an NMS Stock ATS's exemption? If so, why? If not, why not, and what would be the appropriate time frame? Please support your arguments.

99. Do you believe that the Commission's proposal to declare ineffective a Form ATS-N Amendment if it finds that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors, is appropriate as a supplement to the proposal that the Commission suspend, limit, or revoke an NMS Stock ATS's exemption from the definition of "exchange" under proposed Rule 304(a)(4)? Why or why not? Please support your arguments.

100. Do you believe there are other processes by which the Commission should enforce the conditions to the Rule 3a1-1(a)(2) exemption? If so, what are they and why would they be preferable to the proposed process?

**D. Rule 304(b): Public Disclosure of Form ATS-N and Related Commission Orders**

The Commission is proposing to make public certain Form ATS-N reports filed by NMS Stock ATSs.<sup>329</sup> Commission orders related to the effectiveness of Form ATS-N will also be publicly posted on the Commission's website. As discussed above, there currently is limited information available to the public about the operations of ATSs that trade NMS stocks and the activities of their broker-dealer operators and the broker-dealer operators' affiliates.<sup>330</sup> Furthermore, as discussed further below, market participants may not be informed about potential conflicts of interest that arise as a result of the other business activities of the broker-dealer operator of the NMS Stock ATS, or its affiliates, such as trading NMS stocks on the NMS Stock ATS or operating multiple trading centers, including multiple ATSs.<sup>331</sup> The only information the Commission currently makes publicly available regarding ATSs is a list, which is updated monthly, of ATSs with a Form ATS on file with the Commission.<sup>332</sup> Therefore, the Commission is proposing Rule 304(b) to mandate greater public disclosure of NMS Stock ATS operations through the publication of Form ATS-N and to provide for the posting of Commission orders on the Commission's website related to the effectiveness of Form ATS-N.

First, the Commission is proposing Rule 304(b)(1) to provide that every Form ATS-N filed pursuant to Rule 304 shall constitute a "report" within the meaning of Sections 11A, 17(a), 18(a), and 32(a) and any other applicable provisions of the Exchange Act. Because proposed

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<sup>329</sup> See proposed Rule 304(b)(1) (providing that every Form ATS-N filed pursuant to Rule 304 shall constitute a "report" within the meaning of Sections 11A, 17(a), 18(a), and 32(a) and any other applicable provisions of the Exchange Act).

<sup>330</sup> See supra Section III.C.

<sup>331</sup> See infra Section VII.

<sup>332</sup> See Alternative Trading System ("ATS") List, available at <http://www.sec.gov/foia/docs/atlist.htm>.

Form ATS-N is a report that is required to be filed under the Exchange Act, it would be unlawful for any person to willfully or knowingly make, or cause to be made, a false or misleading statement with respect to any material fact in Form ATS-N.<sup>333</sup> The Commission notes that proposed Rule 304(b)(1) is nearly identical to current Rule 301(b)(2)(vi),<sup>334</sup> which provides that every notice or amendment filed pursuant to Rule 301(b)(2), including Form ATS, shall constitute a “report” within the meaning of Sections 11A, 17(a), 18(a), and 32(a), and any other applicable provisions of the Exchange Act.<sup>335</sup>

Under proposed Rule 304(b)(2), the Commission would make public via posting on the Commission’s website, each: (A) order of effectiveness of a Form ATS-N; (B) order of ineffectiveness of a Form ATS-N; (C) effective Form ATS-N; (D) filed Form ATS-N Amendment; (E) order of ineffectiveness of a Form ATS-N Amendment; (F) notice of cessation; and (G) order suspending, limiting, or revoking the exemption from the definition of an “exchange” pursuant to Exchange Act Rule 3a1-1(a)(2). Proposed Rule 304(b)(3) would require each NMS Stock ATS to make public via posting on its website a direct URL hyperlink to the Commission’s website that contains the documents enumerated in proposed Rule 304(b)(2).

Once the Commission has declared a Form ATS-N effective, the Commission preliminarily believes that making Form ATS-N public would provide market participants with important information about the operations of the NMS Stock ATS and its broker-dealer operator and the broker-dealer operator’s affiliates. As discussed further below, proposed Form ATS-N would provide information about the broker-dealer operator and the activities of the broker-

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<sup>333</sup> See 15 U.S.C. 78ff(a).

<sup>334</sup> 17 CFR 242.301(b)(2)(vi).

<sup>335</sup> 15 U.S.C. 78k-1, 78q(a), 78r(a), and 78ff(a). See 17 CFR 242.301(b)(2)(vi).

dealer operator and its affiliates in connection with the NMS Stock ATS, including: their operation of trading centers and other NMS Stock ATSs; products and services offered to subscribers; arrangements with unaffiliated trading centers; trading activities on the NMS Stock ATS; smart order router (or similar functionality) and algorithms used to send or receive orders or other trading interest to or from the ATS; personnel and third parties used to operate the NMS Stock ATS; differences in the availability of ATS services, functionalities, or procedures; and safeguards and procedures to protect subscribers' confidential trading information.<sup>336</sup> Proposed Form ATS-N would also provide market participants with important information about the manner of operations of the NMS Stock ATS, including: subscribers; hours of operation; types of orders; connectivity, order entry, and co-location procedures; segmentation of order flow and notice about segmentation; display of order and other trading interest; trading services, including matching methodologies, order interaction rules, and order handling, and execution procedures; procedures governing suspension of trading and trading during a system disruption or malfunction; opening, re-opening, closing, and after hours procedures; outbound routing services; fees; market data; trade reporting; clearance and settlement; order display and execution access; fair access; and market quality statistics published or provided to one or more subscribers.<sup>337</sup> Accordingly, the Commission proposes to make public – via the public posting of Form ATS-N on the Commission's website – information that it preliminarily believes should be

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<sup>336</sup> See infra Section VII (discussing proposed disclosure requirements related to broker-dealer operators under Form ATS-N).

<sup>337</sup> See infra Section VIII (discussing proposed operational disclosure requirements of Form ATS-N).

easily accessible to all market participants so that market participants may better evaluate how to achieve their investing or trading objectives.

The Commission would not post on its website a filed Form ATS-N before the Commission declares that Form ATS-N effective. Under the proposal, an NMS Stock ATS that was not in operation as of the effective date of proposed Rule 304 may not commence operations as an NMS Stock ATS until the Commission issues an order declaring its Form ATS-N effective.<sup>338</sup> Additionally, if the Commission declares ineffective a Form ATS-N filed by a legacy NMS Stock ATS, that ATS would be prohibited from operating as an NMS Stock ATS going forward.<sup>339</sup> Furthermore, while the Commission is reviewing a Form ATS-N prior to declaring it effective or ineffective, Commission staff would likely engage in discussions with the entity regarding its disclosures and could request that the entity revise or augment its disclosures to provide market participants with greater clarity regarding the entity's operations. Accordingly, the Commission preliminarily believes that it would be premature to provide market participants with information regarding an initial Form ATS-N filing until after it is declared effective.

The proposal to make public each Form ATS-N Amendment upon filing with the Commission is to provide market participants with immediate transparency into the operations of an NMS Stock ATS, which would be operational and to which market participants might currently enter—or consider entering—orders for execution. The Commission preliminarily believes that making public Form ATS-N Amendments would benefit market participants by

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<sup>338</sup> See proposed Rule 304(a)(1)(iv).

<sup>339</sup> Id. Nothing would preclude the NMS Stock ATS from later submitting a new or revised Form ATS-N for consideration by the Commission.

allowing them to obtain current information regarding changes to the operation of an NMS Stock ATS and its relationship with its broker-dealer operator and the broker-dealer operator's affiliates; if it would benefit their investment or trading strategies, market participants would also be able to continually evaluate that NMS Stock ATS as a potential destination to route their orders. The Commission preliminarily believes that, while Form ATS-N Amendments would be publicly posted before the Commission has completed its review, it would be useful to market participants to have immediate access to the disclosures contained in an amendment so market participants may, for example, assess and prepare for upcoming material changes on an NMS Stock ATS or more quickly understand any operational changes that have occurred over the previous quarter on the NMS Stock ATS. The Commission also proposes to make the public aware of which Form ATS-N Amendments filed by NMS Stock ATSS posted on the Commission's website are pending Commission review and could still be declared ineffective. The Commission believes that publicly posting filed Form ATS-N Amendments would strike the right balance of enabling market participants to better understand upcoming or recent changes to an operational NMS Stock ATS in a timely manner, while informing market participants that the Form ATS-N Amendment is pending Commission review and could still be declared ineffective.<sup>340</sup>

The Commission also preliminarily believes that making public each properly filed Form ATS-N notice of cessation would provide the public with notice that the NMS Stock ATS will cease operations and that the organization, association, or group of persons no longer operates

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<sup>340</sup> Market participants would also be made aware if the Commission declares a Form ATS-N Amendment ineffective, because the Commission would also post each order of ineffectiveness of a Form ATS-N Amendment. See proposed Rule 304(b)(2)(E).

pursuant to the exemption provided under Exchange Act Rule 3a1-1(a)(2). The notice of cessation would provide market participants with the date that the NMS Stock ATS will cease operations, as designated by the NMS Stock ATS. Market participants would be able to use this information to make arrangements to select alternative routing destinations for their orders.

Furthermore, the Commission understands that many broker-dealer operators maintain websites for their NMS Stock ATSs. The Commission preliminarily believes that market participants would find it helpful for an NMS Stock ATS to make market participants aware that certain of the NMS Stock ATS's Form ATS-N filings are publicly posted on the Commission's website. Therefore, to the extent that an NMS Stock ATS has a public website, the Commission is proposing that Rule 304(b)(3) require each NMS Stock ATS that has a website to post on the NMS Stock ATS's website a direct URL hyperlink to the Commission's website that contains the documents enumerated in proposed Rule 304(b)(2), which includes the NMS Stock ATS's Form ATS-N filings. The Commission preliminarily believes that this requirement would make it easier for market participants to review an NMS Stock ATS's Form ATS-N filings by providing an additional means for market participants to locate Form ATS-N filings that are posted on the Commission's website.

The Commission preliminarily believes that publicly posting Form ATS-N filings on the timelines described above is important because most market participants do not have access to information that permits them to adequately compare and contrast how some NMS Stock ATSs would handle their orders against how a given national securities exchange or other NMS Stock ATS would handle their orders. Currently, a Form ATS filed with the Commission by an NMS

Stock ATS is “deemed confidential when filed” under Rule 301(b)(2)(vii) of Regulation ATS,<sup>341</sup> whereas a national securities exchange is required to both (i) make available to the public its entire rule book and (ii) publicly file all proposed rule changes pursuant to Section 19(b) of the Exchange Act.<sup>342</sup> The Commission preliminary believes that since the adoption of Regulation ATS, the market in execution services for NMS stocks has evolved such that trading functions of NMS Stock ATSs have become more functionally similar to those of national securities exchanges.<sup>343</sup> Unless an NMS Stock ATS voluntarily publicizes how those functionalities operate and affect the handling of subscriber orders, there is no publicly available information for market participants to use in order to compare and contrast the trading platform of an NMS Stock ATS with that of a national securities exchange. Accordingly, through Form ATS-N, the Commission proposes to require disclosures that would provide information that market participants could use to compare and contrast the important order handling features, and other important functionalities, of an NMS Stock ATS with those of other NMS Stock ATSs or national securities exchanges. The Commission therefore proposes to make those disclosures public so that market participants would have access to important information when evaluating trading venues.

Additionally, the Commission preliminarily believes that, given changes with respect to NMS Stock ATSs since the adoption of Regulation ATS,<sup>344</sup> the reasons given in the past for maintaining the confidentiality of Form ATS filings are no longer justified for NMS Stock ATSs

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<sup>341</sup> See 17 CFR 240.301(b)(2)(vii).

<sup>342</sup> See 15 U.S.C. 78s(b).

<sup>343</sup> See supra Section III.B.

<sup>344</sup> See generally supra Section III.

in light of the benefits of operational transparency for NMS Stock ATSs that are discussed above. First, when the Commission adopted Regulation ATS, it chose, at that time, to deem Form ATS confidential because “[i]nformation required on Form ATS may be proprietary and disclosure of such information could place alternative trading systems in a disadvantageous competitive position.”<sup>345</sup> As noted above, the Commission preliminarily believes that NMS Stock ATSs have generally evolved to the point that their trading functionalities often resemble those of national securities exchanges. The Commission preliminarily believes that much of the type and level of information that would have to be publicly disclosed by an NMS Stock ATS pursuant to this proposal is very similar to information that national securities exchanges must publicly disclose. For instance, proposed Form ATS-N would require an NMS Stock ATS to disclose, among other things, information about available order types and modifiers, hours of operations, connectivity, order entry, co-location, order display, matching methodologies, and order interaction procedures, all of which must be publicly disclosed by national securities exchanges. Accordingly, the Commission preliminarily believes that, in the current market environment, the disclosures mandated by Form ATS-N would not place NMS Stock ATSs at a competitive disadvantage with respect to national securities exchanges.<sup>346</sup>

Second, when the Commission adopted Regulation ATS, it sought to “encourage candid and complete filings in order to make informed decisions and track market changes,” and believed that keeping the reports filed on Form ATS confidential would “provide[] respondents

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<sup>345</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70864.

<sup>346</sup> See *infra* Section XIII.C.2.

with the necessary comfort to make full and complete filings.”<sup>347</sup> Based on Commission experience, however, many Form ATS filings currently provide only rudimentary and summary information about the manner of operation of NMS Stock ATSs, which often requires the Commission and its staff to ask the ATSs follow-up questions, and results in ATSs filing follow-up amendments, to fully disclose how they operate. Thus, the Commission preliminarily believes that maintaining the confidentiality of Form ATS filings with regard to NMS Stock ATSs has not resulted uniformly in ATSs “mak[ing] full and complete filings.”

#### Request for Comment

101. Do you believe market participants currently have access to information about the operations of NMS Stock ATSs and the activities of their broker-dealer operators and the broker-dealer operators’ affiliates, either through private disclosures from NMS Stock ATSs, from NMS Stock ATSs that voluntarily make their Forms ATS public, or from NMS Stock ATSs that issue frequently asked questions about their operations, including changes to their operations, that is sufficient to help market participants select the markets to which to route and execute their orders? Why or why not? Please support your arguments.
102. Do you believe the Commission should adopt the proposal to make public certain Form ATS-N filings by NMS Stock ATSs? Why or why not? Please support your arguments.
103. Do you believe the Commission should adopt the proposal to require an NMS Stock ATS to post on the NMS Stock ATS’s website a direct URL hyperlink to

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<sup>347</sup> See Regulation ATS Adopting Release, supra note 7, at 70864.

the Commission's website that contains the documents enumerated in proposed Rule 304(b)(2)? Why or why not? Please support your arguments.

104. Do you believe the Commission should require each NMS Stock ATS to directly post its Form ATS-N filings on the NMS Stock ATS's website? If so, why, and which Form ATS-N filings? If not, why not? Please support your arguments.
105. Do you believe the Commission should require each NMS Stock ATS to directly post Commission orders related to the effectiveness or ineffectiveness of the NMS Stock ATS's Form ATS-N, Form ATS-N Amendments, or both on the website of the NMS Stock ATS? If so, why, and which orders should NMS Stock ATSs be required to post? If not, why not? Please support your arguments.
106. Do you believe that the Commission should make public on its website the Form ATS-N of an NMS Stock ATS that was not in operation as of the effective date of proposed Rule 304 during the Commission's review period and prior to declaring the Form ATS-N effective or ineffective? Why or why not? Please support your arguments.
107. Do you believe that the Commission should make public on its website a Form ATS-N that it has declared ineffective? Why or why not? Please support your arguments.
108. Do you believe that the Commission should make public on its website a Form ATS-N filed by a legacy NMS Stock ATS during the Commission's review period and prior to its declaring the Form ATS-N effective or ineffective? Why or why not? Please support your arguments?

109. Do you believe that the Commission should adopt the proposal to make public on its website all Form ATS-N Amendments during the Commission's review period and prior to its determination as to whether a Form ATS-N Amendment should be declared ineffective? If so, why? If not, why not? Please support your arguments.
110. Do you believe that the Commission should adopt the proposal whereby the Commission would continue to make public on its website a Form ATS-N Amendment that it has declared ineffective? Why or why not? Please support your arguments.
111. Do you believe the Commission's current practice of making publicly available a list of ATSs with a Form ATS on file with the Commission puts market participants on sufficient notice of the regulatory status of NMS Stock ATSs with which they may do business? Why or why not? Please support your arguments.
112. Does the Commission's current practice of making publicly available a list of ATSs with a Form ATS on file with the Commission create the potential for market participants to misunderstand the operations of the market? If so, how? If not, why not? Please support your arguments.
113. Do you believe that market participants currently have sufficient information regarding the activities of an NMS Stock ATS's broker-dealer operator and its affiliates as they relate to the ATS, including changes to such activities, to evaluate conflicts of interest that may arise out of the position that the broker-dealer occupies as the operating entity of the NMS Stock ATS? Why or why not? Please support your arguments.

114. Do you believe the Commission's proposal to make public certain Form ATS-N filings would better enable market participants to evaluate conflicts of interest that may arise out of the position that the broker-dealer occupies as the operating entity of the NMS Stock ATS? Why or why not? Please support your arguments.
115. Do you believe that making public Form ATS-N filings would place NMS Stock ATSS at a competitive disadvantage with respect to other trading centers, including national securities exchanges? Why or why not? Please support your arguments.
116. Do you believe that making public Form ATS-N filings would incentivize NMS Stock ATSS to make more accurate, current, and complete disclosures? Why or why not? Please support your arguments.
117. Do you believe the Commission should continue to make public a Form ATS-N or Form ATS-N Amendments where the Commission has suspended, revoked, or limited the NMS Stock ATS's exemption pursuant to Rule 304(a)(4)? Why or why not? Please support your arguments.
118. Do you believe that responding to questions on proposed Form ATS-N would require an NMS Stock ATS to disclose proprietary information that could place the NMS Stock ATS or its broker-dealer operator's other business activities at a competitive disadvantage? If so, please identify the question on the Form ATS-N and specify what information in response to that question would result in the disclosure of proprietary information and describe why the disclosure could create a competitive disadvantage for the NMS Stock ATS or its broker-dealer operator's other business activities.

119. In light of the information that national securities exchanges, which compete with NMS Stock ATSS, are required to disclose regarding their operations, should NMS Stock ATSS continue to be eligible for the exemption from the definition of exchange without having to disclose such information? Why or why not? Please explain in detail.

**E. Rule 304(c)(1) and (2): Proposed Form ATS-N Requirements**

Proposed Rule 304(c)(1) would require NMS Stock ATSS to respond to each item on Form ATS-N, as applicable, in detail and disclose information that is accurate, current, and complete. The Commission preliminarily believes that market participants would use information disclosed on proposed Form ATS-N to evaluate whether a particular NMS Stock ATS would be a desirable venue to which to route their orders. In addition, the Commission intends to use the information disclosed on the Form ATS-N to exercise oversight over and monitor developments of NMS Stock ATSS. Given these potential uses, the Commission preliminarily believes that it is important that the Form ATS-N contain detailed disclosures that are accurate, current, and complete.

The Commission notes that Regulation ATS requires NMS Stock ATSS to be registered as broker-dealers with the Commission, which entails becoming a member of FINRA and fully complying with the broker-dealer regulatory regime. FINRA Rule 3130 requires each member to designate and specifically identify to FINRA one or more principals to serve as a chief compliance officer and each member to have its chief executive officer certify annually that the member has in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable FINRA rules, MSRB rules and federal securities laws and regulations, and that the

chief executive officer(s) has conducted one or more meetings with the chief compliance officer(s) in the preceding 12 months to discuss such processes.<sup>348</sup> The Commission requests comment on whether the certification required under FINRA Rule 3130 will help ensure that the broker-dealer operator of the NMS Stock ATS complies with proposed Rule 304, including

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<sup>348</sup> See FINRA Rule 3130(b). FINRA Rule 3120(c) sets forth the following:

The certification shall state the following:

The undersigned is/are the chief executive officer(s) (or equivalent officer(s)) of (name of member corporation/partnership/sole proprietorship) (the "Member"). As required by FINRA Rule 3130(b), the undersigned make(s) the following certification:

1. The Member has in place processes to:

(A) establish, maintain and review policies and procedures reasonably designed to achieve compliance with applicable FINRA rules, MSRB rules and federal securities laws and regulations;

(B) modify such policies and procedures as business, regulatory and legislative changes and events dictate; and

(C) test the effectiveness of such policies and procedures on a periodic basis, the timing and extent of which is reasonably designed to ensure continuing compliance with FINRA rules, MSRB rules and federal securities laws and regulations.

2. The undersigned chief executive officer(s) (or equivalent officer(s)) has/have conducted one or more meetings with the chief compliance officer(s) in the preceding 12 months, the subject of which satisfy the obligations set forth in FINRA Rule 3130.

3. The Member's processes, with respect to paragraph 1 above, are evidenced in a report reviewed by the chief executive officer(s) (or equivalent officer(s)), chief compliance officer(s), and such other officers as the Member may deem necessary to make this certification. The final report has been submitted to the Member's board of directors and audit committee or will be submitted to the Member's board of directors and audit committee (or equivalent bodies) at the earlier of their next scheduled meetings or within 45 days of the date of execution of this certification.

4. The undersigned chief executive officer(s) (or equivalent officer(s)) has/have consulted with the chief compliance officer(s) and other officers as applicable (referenced in paragraph 3 above) and such other employees, outside consultants, lawyers and accountants, to the extent deemed appropriate, in order to attest to the statements made in this certification.

proposed Rule 304(c)(1), which would require the accurate, current, and complete disclosures on Form ATS-N.

Request for Comment

120. Do you believe that the certification required under FINRA Rule 3130 will help ensure an NMS Stock ATS's compliance with proposed Rule 304, including the requirement that disclosures on Form ATS-N are accurate, current, and complete? Why or why not? Please support your arguments.

Proposed Rule 304(c)(2) would provide that any report required to be filed with the Commission under proposed Rule 304 of Regulation ATS must be filed electronically on Form ATS-N, and include all information as prescribed in proposed Form ATS-N and the instructions thereto. The Commission's proposal contemplates the use of the electronic form filing system ("EFFS") to file a completed Form ATS-N. Based on the widespread use and availability of the Internet, the Commission preliminarily believes that filing Form ATS-N in an electronic format would be less burdensome and a more efficient filing process for NMS Stock ATSs and the Commission, as it is likely to be less expensive and cumbersome than mailing paper forms to the Commission. The proposed Form ATS-N would require an electronic signature to help ensure the authenticity of the filing. The Commission preliminarily believes these proposed requirements would expedite communications between the Commission and its staff and the broker-dealer operator concerning the NMS Stock ATS and help to ensure that only personnel authorized by the NMS Stock ATS are filing required materials. This proposed requirement is intended to provide a uniform manner in which the Commission would receive—and the broker-dealer operator would file—the Form ATS-N made pursuant to proposed Rule 304 of Regulation ATS. Also, NMS Stock ATSs would be able to review how other filers that were allowed to

become effective responded to the same questions on Form ATS-N for guidance on how to respond. Additionally, the consistent framework would make it easier and more efficient for the Commission and market participants reviewing the disclosures to promptly review, analyze, and respond, as necessary, to the information proposed to be provided.<sup>349</sup>

Further, the Commission also is proposing that documents filed through the EDFS system must be in a text-searchable format without the use of optical character recognition. The Commission believes that proposing to require documents to be filed in a text-searchable format would allow the Commission and its staff and market participants to efficiently review and analyze information provided on proposed Form ATS-N. In particular, a text-searchable format would allow the Commission and its staff to better gather, analyze, and use data filed as exhibits, whereas a non-text-searchable format filing would require significantly more steps and labor to review and analyze data.

The Commission is proposing that proposed Form ATS-N be filed with the Commission in a structured format. The Commission preliminarily believes that proposing Form ATS-N to be filed with the Commission in a structured format could allow the Commission and market participants to better search and analyze information about NMS Stock ATSS. The Commission is proposing that Parts I (Name) and II (Broker-Dealer Operator Registration and Contact Information) of proposed Form ATS-N would be provided as fillable forms on the Commission's EDFS system. The Commission is proposing that Part III (Activities of the Broker-Dealer Operator and Affiliates) of proposed Form ATS-N would be filed in a structured format whereby

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<sup>349</sup> This proposed requirement is consistent with electronic-reporting standards set forth in Form SCI. See SCI Adopting Release, *supra* note 17, at 72357 (discussing electronic filing requirements of Form SCI).

the filer would provide checkbox responses to certain questions and narrative responses that are block-text tagged by Item. The Commission is proposing that Part IV (The NMS Stock ATS Manner of Operations) of proposed Form ATS-N would also be filed in a structured format in that the filer would block-text tag narrative responses by Item. The Commission is proposing that Part V (Contact Information, Signature Block, and Consent to Service) of proposed Form ATS-N would be provided as fillable forms on the Commission's EFTS system.

The Commission notes that there are a variety of methods by which information can be collected and structured for review and analysis. For example, some or all of the information provided on Form ATS-N could be structured according to a particular standard that already exists, or a new taxonomy that the Commission creates, or as a single machine-readable PDF. Given the Commission's proposal that information on Form ATS-N be filed in a structured format, the Commission seeks comment on the manner in which proposed Form ATS-N could be structured to better enable the Commission and market participants to collect and analyze the data.

#### Request for Comment

121. Do you believe that the electronic filing requirement of proposed Rule 304(c)(2) is appropriate? Do you believe that the electronic filing of Form ATS-N would be less burdensome and/or a more efficient filing process for NMS Stock ATSs compared to delivering the Form ATS-N by mail on paper? Alternatively, would the submission of proposed Form ATS-N via electronic mail to one or more Commission email addresses be a more appropriate way for NMS Stock ATSs to file Form ATS-N with the Commission? Are there other alternative methods that would be preferable? If so, please describe. Is the proposal to require an

electronic signature appropriate? If not, why not? Please support your arguments.

122. Should the Commission adopt the proposal that proposed Form ATS-N should be filed with the Commission in a structured format? Why or why not? If so, what standards of structuring should be used for information to be provided on proposed Form ATS-N? Please explain. If not, what format should proposed Form ATS-N take? Please identify the format and explain.
123. Are there any specific aspects of proposed Form ATS-N that should or should not be provided in a structured format? Please identify those aspects of proposed Form ATS-N that should or should not be provided in a structured format and explain why those aspects of the form should or should not be structured.
124. Should the Commission adopt the proposal to require documents to be filed in a text-searchable format on proposed Form ATS-N? Why or why not? Please support your arguments.

## V. Proposed Form ATS-N: Submission Type and Part I of Form ATS-N

Proposed Form ATS-N would require that an entity identify the type of filing by marking the appropriate checkbox. The Form ATS-N filing may either be a Form ATS-N, a Form ATS-N Amendment, or a notice of cessation. In addition, proposed Form ATS-N would require the NMS Stock ATS to indicate whether a Form ATS-N Amendment is being submitted as a material amendment, periodic amendment, or correcting amendment. The Commission is also proposing that, for an Form ATS-N Amendment, the NMS Stock ATS provide a brief narrative description of the amendment so market participants can quickly understand the nature of the Form ATS-N Amendment.<sup>350</sup> For notices of cessation, proposed Form ATS-N would require the date that the NMS Stock ATS will cease to operate. A Form ATS-N filer may also withdraw a previously filed Form ATS-N.<sup>351</sup>

Part I of proposed Form ATS-N would require the name of the broker-dealer operator and the NMS Stock ATS. Rule 301(b)(1) requires that an ATS, including an NMS Stock ATS, register as a broker-dealer under Section 15 of the Exchange Act.<sup>352</sup> Today, while some broker-dealers are registered with the Commission for the sole purpose of operating as an ATS, most broker-dealer operators of ATSs engage in brokerage and/or dealing activities in addition to

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<sup>350</sup> For a Form ATS-N Amendment, the NMS Stock ATS would also be required to attach as Exhibit 3A and/or Exhibit 4A a redline(s), showing changes to Part III and/or Part IV of proposed Form ATS-N, respectively, in order to point out the amendment(s) to its prior Form ATS-N filing. The Commission preliminarily believes that requiring NMS Stock ATSs to attach redlines to their Form ATS-N Amendments would better enable market participants and the Commission to review Form ATS-N Amendments in a more efficient manner.

<sup>351</sup> Instruction B to proposed Form ATS-N would provide that if an NMS Stock ATS determines to withdraw a Form ATS-N, it must select the appropriate checkbox and provide the correct file number to withdraw the submission.

<sup>352</sup> 17 CFR 242.301(b)(1); 15 U.S.C. 78o.

operating an NMS Stock ATS. In some cases, broker-dealers operate multiple NMS Stock ATSS.<sup>353</sup> To identify the registered broker-dealer for an NMS Stock ATS and to assist the Commission in collecting and organizing its filings, proposed Form ATS-N would require the name of the registered broker-dealer for the NMS Stock ATS (i.e., the broker-dealer operator), as it is stated on Form BD, in Part I, Item 1 of proposed Form ATS-N. The name of the registered broker-dealer for the NMS Stock ATS would also assist the Commission in ensuring that the NMS Stock ATS has appropriately registered as a broker-dealer as part of its exemption from exchange registration under Exchange Act Rule 3a1-1(a)(2). To the extent that a “DBA” (doing business as) is used to identify the NMS Stock ATS to the public or the Commission, or if a registered broker-dealer operates multiple NMS Stock ATSS, proposed Form ATS-N would require the full name of the NMS Stock ATS under which business is conducted, if any, in Part I, Item 2 of proposed Form ATS-N. Part I, Item 3 of proposed Form ATS-N would require the NMS Stock ATS to provide its Market Participant Identifier (“MPID”) for the NMS Stock ATS.<sup>354</sup> The Commission preliminarily believes that providing the name of the NMS Stock ATS or DBA and its MPID would provide clarity to the public and Commission about the identity under which the business of the NMS Stock ATS is conducted. Proposed Form ATS-N would

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<sup>353</sup> A broker-dealer operator would be required to file a separate Form ATS-N for each NMS Stock ATS operated by the broker-dealer. See Instruction A of proposed Form ATS-N.

<sup>354</sup> An MPID, or other mechanism or mnemonic, is used to identify a market participant for the purposes of electronically accessing a national securities exchange or an ATS. See, e.g., Securities Exchange Act Release No. 63241 (November 3, 2010), 75 FR 69792 (November 15, 2010). ATSS are required to use a unique MPID for the ATS when reporting trade information to FINRA. See FINRA ATS Reporting Approval, supra note 122.

also require an ATS to identify whether it is currently operating pursuant to a previously filed initial operation report on Form ATS.

Request for Comment

125. Do you believe that Part I of proposed Form ATS-N is sufficiently clear with respect to the disclosures that would be required? If not, how should Part I of proposed Form ATS-N be revised to provide additional clarity? Please explain in detail and support your arguments.
126. Do you believe there is other information that market participants might find relevant or useful with regard to the disclosures in Part I? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
127. Do you believe that the broker-dealer operator should be required to identify the type of Form ATS-N filing (i.e., Form ATS-N, Form ATS-N Amendment, notice of cessation, or withdrawal) by marking the appropriate checkbox, and for notices of cessation, provide the date that the NMS Stock ATS will cease to operate? Why or why not? Please support your arguments.
128. Do you believe that the broker-dealer operator should be required to provide a brief summary of a Form ATS-N Amendment? Why or why not? Please support your arguments.
129. Do you believe that a broker-dealer operator should be allowed to withdraw a previously filed Form ATS-N? Why or why not? Please support your arguments.

If so, when should a broker-dealer operator be permitted to withdraw a previously filed Form ATS-N? Please explain.

130. Do you believe that the broker-dealer operator should be required to disclose the date on which it commenced, or intends to commence, operation of the NMS Stock ATS in Part I of Form ATS-N? Why or why not? Please support your arguments.
131. Do you believe that the Commission should require the MPID of the NMS Stock ATS as a required disclosure on proposed Form ATS-N? Why or why not? Please support your arguments.
132. What are the potential costs and benefits of disclosing the information required by Part I of proposed Form ATS-N? Would the proposed disclosures in Part I of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information? Why or why not? Please support your arguments.

**VI. Part II of Proposed Form ATS-N: Broker-Dealer Operator Registration Information**

Part II of proposed Form ATS-N would require certain general information regarding the broker-dealer operator and the NMS Stock ATS. With respect to the broker-dealer operator, Part II of proposed Form ATS-N would require registration information including: its SEC File Number, Central Registration Depository (“CRD”) Number, effective date of the broker-dealer operator’s registration with the Commission, the name of the national securities association with which it is a member, and the effective date of broker-dealer operator’s membership with the national securities association (e.g., FINRA). The Commission proposes to require this information to assess whether the NMS Stock ATS has complied with the requirement to register as a broker-dealer pursuant to Rule 301(b)(1) of Regulation ATS. This information also would expedite the Commission’s communications with the broker-dealer operator’s self-regulatory organization as needed.

Additionally, Part II of proposed Form ATS-N would require certain information regarding the legal status of the broker-dealer operator. Specifically, proposed Form ATS-N would require that the broker-dealer operator provide its legal status (e.g., corporation, partnership, sole proprietorship) and except in the case of a sole proprietorship, the date of formation and state or country in which it is formed. The Commission is proposing to require the information related to the broker-dealer operator’s legal status to help ensure that the broker-dealer operator has appropriately filed as a legal entity (except in the case of sole proprietorships).

Proposed Form ATS-N would also require the address of the physical location of the NMS Stock ATS matching system and, if it is different from the physical location, the mailing

address of the NMS Stock ATS. If the broker-dealer operator is a sole proprietorship and an address of the NMS Stock ATS is a private residence, the Commission would not make that information available on the Commission's website due to concerns about the confidentiality of personally identifiable information. Furthermore, Part II would require the NMS Stock ATS to provide a URL address for the website of the NMS Stock ATS, and in the signature block in Part V of proposed Form ATS-N, the representative of the broker-dealer operator would also be required to provide his or her business contact information, including the person's name and title, telephone number, and e-mail address.<sup>355</sup> This information would facilitate communication with the broker-dealer operator and the NMS Stock ATS during the Commission's review of a Form ATS-N and later as necessary as part of the Commission's ongoing monitoring of the NMS Stock ATS. To the extent the broker-dealer operator's contact information that is provided in Part II is made publicly available, that information would also facilitate communication between subscribers and the broker-dealer operator.

Part II of proposed Form ATS-N would also require an NMS Stock ATS to attach, as Exhibit 1, a copy of any materials currently provided to subscribers or other persons, related to

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<sup>355</sup> The Commission would also keep the contact information of the broker-dealer operator's representative confidential, subject to applicable law.

Consistent with the requirements of proposed Form ATS-N, the signature block in Part V would also require the NMS Stock ATS to consent that service of any civil action brought by, or notice of any proceeding before, the Commission or a SRO in connection with the ATS's activities may be given by registered or certified mail or email to the contact employee at the primary street address or email address, or mailing address if different, given in Part I. The signatory would further represent that the information and statements contained on the submitted Form ATS-N, including exhibits, schedules, attached documents, and any other information filed, are current, true, and complete.

the operations of the NMS Stock ATS or the disclosures on Form ATS-N.<sup>356</sup> The Commission understands that some ATSs may provide to subscribers, or other persons, marketing material or other material containing important information about the ATS's operations in FIX protocol procedures, rules of engagement/user manuals, or frequently asked questions. These documents may include information regarding, among other things, the order matching procedures, priority rules, order types, and order entry and execution procedures of the ATS, and in some instances, such documents may contain important information about an NMS Stock ATS that may not be specified in the required disclosures under proposed Form ATS-N. The Commission notes that the purpose of proposed Form ATS-N is to provide operational transparency with regard to the NMS Stock ATS. To the extent that the NMS Stock ATS discloses information on standardized materials provided to certain subscribers, whether an individual or on group basis, the Commission preliminarily believes the NMS Stock ATS should make this information available to all subscribers, and therefore the Commission is proposing to require these materials be filed as an attachment to Exhibit 1 to proposed Form ATS-N. The Commission further notes that this requirement is similar to the requirement of subpart (f) of Exhibit F on existing Form ATS.<sup>357</sup>

Proposed Form ATS-N also would require that the broker-dealer operator attach, as Exhibits 2A and 2B (or provide a link to the relevant URL address where the required documents can be found), a copy of the most recently filed Schedule A of the broker-dealer operator's Form

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<sup>356</sup> For currently operating NMS Stock ATSs that file a Form ATS-N, each ATS would only be required to provide the materials it currently provides to subscribers or other persons and would not be required to attach materials provided to subscribers or other person in the past.

<sup>357</sup> Subpart (f) of Form ATS requires a copy of the ATS's subscriber manual and any other materials provided to subscribers.

BD disclosing information related to direct owners and executive officers, and a copy of the most recently filed Schedule B of the broker-dealer operator's Form BD disclosing information related to indirect owners, respectively. The proposed Form ATS-N would require information from the broker-dealer operator's Schedule A and Schedule B of Form BD to help market participants understand the persons and entities that directly and indirectly own the broker-dealer operator. The Commission is requiring that NMS Stock ATSS provide names of the direct and indirect owners of the broker-dealer operator on Form ATS-N, even though the same information is provided on Form BD, because information about the ownership of the broker-dealer operator will enable market participants to understand better any potential conflicts of interest that may arise therefrom, which is one of the central purposes of proposed Form ATS-N. Also, providing this information on Form ATS-N would facilitate the Commission's, as well as market participants', analysis of the ownership and any potential for conflicts arising therefrom by providing this information all on one form. Moreover, the Commission preliminarily believes it is appropriate for NMS Stock ATSS to provide this information using a URL address for these documents in lieu of attaching the actual documents to their Form ATS-N filings.

Request for Comment.

133. Do you believe that Part II of proposed Form ATS-N is sufficiently clear with respect to the disclosures that would be required? If not, how should Part II of proposed Form ATS-N be revised to provide additional clarity? Please explain in detail.
134. Do you believe there is other information that market participants might find relevant or useful with regard to the disclosures in Part II? If so, describe such information and explain whether, and if so why, such information should be

- required to be provided under proposed Form ATS-N. Please support your arguments.
135. Do you believe that the Commission should require the effective date of broker-dealer registration with the Commission as a required disclosure on proposed Form ATS-N? Why or why not? Please support your arguments.
136. Do you believe that the Commission should require the SEC File number of the broker-dealer operator as a required disclosure on proposed Form ATS-N? Why or why not? Please support your arguments.
137. Do you believe that the Commission should require the CRD number of the broker-dealer operator as a required disclosure on proposed Form ATS-N? Why or why not? Please support your arguments.
138. Do you believe that the Commission should require the address of the physical location of the NMS Stock ATS's matching system as a required disclosure on proposed Form ATS-N? Why or why not? Please support your arguments.
139. Do you believe that the Commission should require the mailing address of the NMS Stock ATS as a required disclosure on proposed Form ATS-N? Why or why not? Please support your arguments.
140. Do you believe that the Commission should require the website URL of the NMS Stock ATS as a required disclosure on proposed Form ATS-N? Why or why not? Please support your arguments.
141. Do you believe that the Commission should require NMS Stock ATSs to disclose materials provided to subscribers or other persons related to the operations of the NMS Stock ATS on proposed Form ATS-N? Why or why not? Please support

your arguments. Do you believe such materials should be provided to the Commission as an Exhibit? Why or why not? Please support your arguments. Do you believe that the NMS Stock ATS should be able to provide a URL where these documents can be found in lieu of providing the documents as an Exhibit? Why or why not? Please support your arguments.

142. Do you believe it is appropriate for the Commission to not make public the address of the NMS Stock ATS that is a sole proprietorship? Why or why not? Please support your arguments.
143. Do you believe it is appropriate for the Commission to not make public the contact information of the broker-dealer operator's representative? Why or why not? Please support your arguments.
144. Do you believe that there is any information, that would be required to be disclosed in Part II of proposed Form ATS-N that the Commission should not require to be disclosed due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
145. What are the potential costs and benefits of disclosing the information required by Part II of proposed Form ATS-N? Would the proposed disclosures in Part II of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information? Why or why not? Please support your arguments.
146. Do you believe there are there certain types of materials provided to subscribers that would be responsive to Exhibit 1 that should or should not be disclosed on Form ATS-N? If so, what types of materials and why? Do you believe an NMS

Stock ATS should provide in response to Exhibit 1 the materials the NMS Stock ATS provides to subscribers such as FIX protocol procedures, rules of engagement/user manuals, frequently asked questions, or marketing materials? Why or why not? Please support your arguments.

147. Do you believe the Commission should require NMS Stock ATSs to provide on Form ATS-N information on Exhibits 2A and 2B, in light of the fact that the information is already provided on Form BD?
148. Do you believe the Commission should require the NMS Stock ATS to provide disclosure about its governance structure and compliance programs and controls to comply with Regulation ATS? Why or why not? If so, what aspects of the NMS Stock ATSs' governance structure and compliance programs and controls to comply with Regulation ATS should the NMS Stock ATS be required to disclose? Please support your arguments.

**VII. Part III of Proposed Form ATS-N: Activities of the Broker-Dealer Operator and Its Affiliates**

**A. The Relationship between the Broker-Dealer Operator's Operation of the NMS Stock ATS and Its Other Operations**

**1. Background**

The Commission preliminarily believes that to understand the operations of an NMS Stock ATS, it is necessary to understand the relationship and interactions between the NMS Stock ATS and its registered broker-dealer operator as well as the relationship and interactions between the NMS Stock ATS and the affiliates of its broker-dealer operator. As previously noted, Rule 301(b)(1) of Regulation ATS requires that an ATS, including an NMS Stock ATS, register as broker-dealer under Section 15 of the Exchange Act (the "broker dealer operator").<sup>358</sup> The broker-dealer operator of the ATS trading platform is legally responsible for all operational aspects of the ATS and for ensuring that the ATS operates in compliance with applicable federal securities laws and the rules and regulations thereunder, including Regulation ATS. The broker-dealer operator, and in some cases, its affiliates,<sup>359</sup> controls access to the ATS and provides the technology and systems that support the trading on the ATS.<sup>360</sup> Based on Commission experience, the broker-dealer operator, or in some cases, its affiliates, directs the personnel that

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<sup>358</sup> 17 CFR 242.301(b)(1); 15 U.S.C. 78o. Additionally, as a registered entity with the Commission, a broker-dealer operating an ATS is subject to applicable federal securities laws, as well as other requirements, including the rules of any SRO of which it is a member.

<sup>359</sup> The Commission is proposing to define "affiliate" for purposes of Form ATS-N as described and discussed further below. See infra note 376 and accompanying text. See also Instruction G of proposed Form ATS-N.

<sup>360</sup> Some technology or functions of an ATS may be licensed from a third party. The broker-dealer operator of the ATS is nonetheless legally responsible for ensuring that all aspects of the ATS comply with applicable laws.

service the ATS or otherwise manages service providers that may perform certain functions of the ATS. The broker-dealer operator, or in some cases, its affiliates, also determines, among other things: (1) what securities will trade on the ATS; (2) who may become subscribers that will participate on the ATS; (3) whether there will be segmented categories of order flow in the ATS, and if so, how the order flow will be segmented; (4) order matching methodologies and priority rules; (5) the rules governing the interaction and execution of orders; and (6) the display, if any, of orders and trading interest. Additionally, the broker-dealer operator, or in some cases, its affiliates, determines the means by which orders are entered on and subscribers access the ATS, in many cases, through the use of a smart order router that is owned and operated by the broker-dealer operator or one of its affiliates. The broker-dealer operator, or in some cases, its affiliates, also controls the market data that the ATS uses to prioritize, match, and execute orders and the transmission of and access to confidential order and execution information sent to and from the ATS.<sup>361</sup> Based on Commission experience, the operations of the NMS Stock ATS and the other operations of the broker-dealer operator are usually closely intertwined as the broker-dealer operator generally leverages its information technology, systems, personnel, and market data, and those of its affiliates, to operate the ATS.

The Commission is also aware that most ATSs that currently transact in NMS stocks are operated by broker-dealers that engage in significant brokerage and dealing activities in addition to their operation of an ATS(s).<sup>362</sup> These multi-service broker-dealers may offer their customers

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<sup>361</sup> For example, the broker-dealer operator determines the source of market data that the NMS Stock ATS uses to calculate the NBBO and how the NBBO will be calculated.

<sup>362</sup> The Commission notes that, based on Form BD disclosures from June of 2015, all but 7 of the 36 broker-dealer operators whose ATSs trade NMS stocks disclose business activities other than operating an ATS. The other business activities disclosed by broker-

a variety of brokerage services, often with or through their affiliates, including algorithmic trading strategy software, agency sales desk support, and automated smart order routing services. Multi-service broker-dealers that also operate an NMS Stock ATS may use the ATS as a complement to the broker-dealer's other service lines and may use the ATS as an opportunity to execute orders "in house" before seeking contra-side interest at other execution venues. For instance, a broker-dealer operator, or its affiliate, may operate, among other things, an OTC market making desk or proprietary trading desks in addition to operating an NMS Stock ATS.<sup>363</sup> A multi-service broker-dealer may also execute orders in NMS stocks internally (and not within its respective NMS Stock ATS(s)) by trading as principal against such orders or crossing orders as agent in a riskless principal capacity, before routing the orders to its NMS Stock ATS(s) or

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dealer operators (and the number of such broker-dealer operators providing such disclosure) include: retailing corporate equity securities over-the-counter (22); put and call broker or dealer or option writer (18); exchange commission business other than floor activities (18); private placements of securities (17); selling corporate debt securities (17); government securities broker (15); trading securities for own account (15); municipal securities broker (13); exchange member engaged in floor activities (13); non-exchange member arranging for transactions in listed securities by exchange member (12); underwriter or selling group participant (corporate securities other than mutual funds) (13); selling interests in mortgages or other receivables (12); making inter-dealer markets in corporate securities over-the-counter (11); government securities dealer (11); municipal securities dealer (11); solicitor of time deposits in a financial institution (7); investment advisory services (7). This data does not include the business activities of affiliates of the broker-dealer operators. Of the 10 ATSs that traded the most NMS stock measured by total shares executed during the second quarter of 2015, 6 disclose on Form BD that they engage in proprietary trading and making inter-dealer markets in corporate securities OTC, and 7 disclose retailing corporate equities OTC. See FINRA's ATS Transparency Data Quarterly Statistics, 2nd Quarter of 2015, available at <http://www.finra.org/industry/ats/ats-transparency-data-quarterly-statistics>.

<sup>363</sup> These non-ATS, OTC activities in NMS stocks may include operating as an OTC market maker, block positioner, or operating an internal broker-dealer system. See 2010 Equity Market Structure Release, supra note 124 at 3599-3600. See also infra note 385 and accompanying text. Additionally, an affiliate of the broker-dealer operator of an NMS Stock ATS may also operate non-ATS trading centers.

another external trading center.<sup>364</sup> Consequently, non-ATS trading centers operated by the broker-dealer operator of an ATS (*i.e.*, internal executions by the broker-dealer outside of an ATS), or its affiliates, often compete with the ATS as a trading venue for the execution of transactions in NMS stocks.

## **2. Potential Conflicts of Interest for the Broker-Dealer Operator or its Affiliates**

Due to the frequent overlap between the operations of the broker-dealer operator or its affiliates outlined above and the operations of ATSS that trade NMS stocks, the Commission preliminarily believes that the interests of the broker-dealer operator or its affiliates sometimes compete with the interests of an ATS's subscribers, or customers of the ATS's subscribers, for executions on the ATS. Accordingly, the Commission preliminarily believes that these competing interests, at times, may give rise to potential conflicts of interest for broker-dealer operators of NMS Stock ATSS or their affiliates. Furthermore, the Commission preliminarily believes that the frequent overlap between the operation of ATSS that trade NMS stocks and the other operations of broker-dealer operators or their affiliates gives rise to the potential for information leakage of subscribers' confidential trading information to other business units of the broker-dealer operator or its affiliates.<sup>365</sup>

When evaluating an NMS Stock ATS as a possible trading venue, a market participant would likely want to know about the various activities in which a broker-dealer operator and its

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<sup>364</sup> 17 CFR 242.600(b)(78).

<sup>365</sup> In the Regulation ATS Adopting Release, the Commission recognized the potential for abuse involving a broker-dealer that operates an ATS and offers other traditional brokerage services, and expressed concern about the potential for the misuse of confidential trading information. *See* Regulation ATS Adopting Release, *supra* note 7, at 70879.

affiliates engage that may give rise to conflicts of interests. For example, as noted above, the broker-dealer operator of an NMS Stock ATS may operate multiple trading centers, which operate as competing trading venues for the execution of trades in NMS stocks. Many broker-dealer operators or their affiliates trade proprietarily on the NMS Stock ATS. If a broker-dealer operator that operates an NMS Stock ATS is also able to trade on that NMS Stock ATS, there may be an incentive for the broker-dealer operator to operate its NMS Stock ATS in a manner that favors the trading activity of the broker-dealer operator's business units or affiliates. A broker-dealer operator of an NMS Stock ATS may provide its other business units or affiliates, who may be subscribers to the NMS Stock ATS, with access to certain services of the NMS Stock ATS that are not provided to other subscribers, which may result in trading advantages to those business units or affiliates.<sup>366</sup> The Commission preliminarily believes that market participants that subscribe and route orders to NMS Stock ATSs would want to know how a broker-dealer operator of an NMS Stock ATS treats subscriber orders versus orders of its business units or its affiliates. The Commission preliminarily believes that customers of the broker-dealer operator, who may also be subscribers to the NMS Stock ATS, would also want to better understand the circumstances in which the broker-dealer operator may send their orders to its NMS Stock ATS, internalize their orders outside of the NMS Stock ATS, or route to another trading venue.

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<sup>366</sup> Such benefits or other advantages could include the NMS Stock ATS providing itself or its affiliates with faster access to the NMS Stock ATS or priority in executions over other subscribers. Unlike registered national securities exchanges, ATSs are not required to have rules that are designed not to permit unfair discrimination; however, the advantages that a broker-dealer operator may provide to itself or its affiliates may not be fully disclosed to subscribers to an ATS.

Concerns regarding potential conflicts of interests involving trading venues that execute securities transactions are not novel.<sup>367</sup> In the context of national securities exchanges, the Commission has expressed concern that the affiliation of a registered national securities exchange with one of its members raises potential conflicts of interest, and the potential for unfair competitive advantage.<sup>368</sup> Because the Commission reviews the rules of registered national securities exchanges, a process which requires, among other things, that to approve certain rule changes the Commission find that the exchange's proposed rule changes are consistent with the Exchange Act,<sup>369</sup> each existing national securities exchange has implemented

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<sup>367</sup> See, e.g., Securities Exchange Act Release Nos. 50700, 69 FR 71256, 71257 (December 8, 2004) (discussing the inherent conflicts of interest between a self-regulatory organization's regulatory obligations and the interests of its members, its market operations, its listed issuers, and, in the case of a demutualized SRO, its shareholders); 50699, 69 FR 71126 (December 8, 2004) (proposing rules that the Commission believed would help insulate the regulatory activities of an exchange or national securities association from the conflicts of interest that otherwise may arise by virtue of its market operations); 63107, 75 FR 65882 (October 26, 2010) (proposing Regulation MC under the Exchange Act to mitigate conflicts of interest regarding ownership interests and voting rights with respect to security-based swap clearing agencies, security-based swap execution facilities, and security-based swap exchanges pursuant to the Dodd Frank Act, Pub. L. No. 111-203, Section 765).

<sup>368</sup> See, e.g., Securities Exchange Act Release Nos. 66808 (April 13, 2012) 77 FR 23294 (April 18, 2012)(SR-BATS-2012-013) (order approving a proposed rule change by BATS Exchange, Inc. ("BATS Exchange") relating to its ability to receive inbound routes of equities orders through BATS Trading, Inc., BATS Exchange's routing broker-dealer, from BATS-Y Exchange, Inc.) at 23295 n.16 and accompanying text; 59281 (January 22, 2009), 74 FR 5014 (January 28, 2009) (SR-NYSE-2008-120) (order approving a joint venture between NYSE and BIDS Holdings L.P.) ("NYSE/BIDS Order"); 54170 (July 18, 2006), 71 FR 42149 (July 25, 2006) (SR-NASDAQ-2006-006) (order approving Nasdaq's proposal to adopt Nasdaq Rule 2140, restricting affiliations between Nasdaq and its members) ("Nasdaq Affiliation Order"); and 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (SR-NYSE-2005-77) (order approving the combination of the New York Stock Exchange, Inc. and Archipelago Holdings, Inc.) ("NYSE/Arca Order").

<sup>369</sup> See 15 U.S.C. 78s(b).

rules that restrict affiliation between the national securities exchange and its members to mitigate the potential for conflicts of interest.<sup>370</sup>

In the context of a national securities exchange's affiliation with one of its members, the Commission's concerns stem from, among other things, the potential for unfair competitive advantages that the affiliated member could have by virtue of informational or operational advantages or the ability to receive preferential treatment.<sup>371</sup> These same concerns are present in the context of trading by the broker-dealer operator, or its affiliates, on the ATS that the broker-dealer operator operates. For example, the potential exists for the broker-dealer operator of an NMS Stock ATS to place its commercial interests, or those of its affiliates, before those of

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<sup>370</sup> For example, registered national securities exchanges have rules that prevent the national securities exchange from being affiliated with a member of the exchange, or with an affiliate of a member of the exchange, absent Commission approval. See, e.g., NYSE Rule 2B, which provides, in part, that: "Without prior SEC approval, the [New York Stock Exchange LLC ("NYSE")] or any entity with which it is affiliated shall not, directly or indirectly, acquire or maintain an ownership interest in a member organization. In addition, a member organization shall not be or become an affiliate of the [NYSE], or an affiliate of any affiliate of the [NYSE] . . . ." See also Nasdaq Rule 2160, and BZX Rule 2.10. In cases where the Commission has approved exceptions to this prohibition, there have been limitations and conditions on the activities of the exchange and its affiliated member designed to address concerns about potential conflicts of interest and unfair competitive advantage. See, e.g., Securities Exchange Act Release No. 58375 (August 18, 2008), 73 FR 49498 (August 21, 2008) (File No. 10-182) (In the Matter of the Application of BATS Exchange, Inc. for Registration as a National Securities Exchange; Findings, Opinion, and Order of the Commission), at 49502 n.90-94 and accompanying text (approving the affiliation between BATS Exchange and its affiliated member BATS Trading in connection with the provision of routing services by BATS Trading for BATS Exchange and subject to certain limitations and conditions).

<sup>371</sup> See, e.g., Nasdaq Affiliation Order, supra note 368, at 42151. The Commission's concern with respect to a national securities exchange's affiliation with one of its members also stemmed from the possible conflicts of interest that could arise between a national securities exchange's self-regulatory obligations and its commercial interest. See id. Because ATSs are not SROs, and therefore do not have self-regulatory obligations, this particular concern is not present in the context of ATSs.

subscribers that route orders to the NMS Stock ATS directly or indirectly through the broker-dealer operator of the NMS Stock ATS or its affiliates. Some of the settled enforcement actions against ATSS that trade NMS stocks highlight this potential.<sup>372</sup> Therefore, as explained further below, the Commission proposes to require NMS Stock ATSS to disclose information about certain aspects of the activities of the NMS Stock ATS's broker-dealer operator, and its affiliates,

<sup>372</sup> See, e.g., In the Matter of ITG Inc. and Alternet Securities Inc., Securities Exchange Act Release No. 75672 (Aug. 12, 2015), available at <https://www.sec.gov/litigation/admin/2015/33-9887.pdf> (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order) (“ITG Settlement”); In the Matter of UBS Securities LLC, Securities Exchange Act Release No. 74060 (Jan. 15, 2015), available at <http://www.sec.gov/litigation/admin/2015/33-9697.pdf> (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order) (“UBS Settlement”); In the Matter of Lavaflow, Inc., Securities Exchange Act Release No. 72673 (Jul. 25, 2014), available at <http://www.sec.gov/litigation/admin/2014/34-72673.pdf> (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order) (“LavaFlow Settlement”); In the Matter of Liquidnet, Inc., Securities Exchange Act Release No. 72339 (Jun. 6, 2014), available at <http://www.sec.gov/litigation/admin/2014/33-9596.pdf> (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order) (“Liquidnet Settlement”); In the Matter of eBX, LLC, Securities Exchange Act Release No. 67969 (Oct. 3, 2012), available at <http://www.sec.gov/litigation/admin/2012/34-67969.pdf> (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order) (“Level Settlement”); In the Matter of Pipeline Trading Systems LLC, Fred J. Federspiel, and Alfred R. Berkeley III, Securities Exchange Act Release No. 9271 (Oct. 24, 2011) (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order), available at <https://www.sec.gov/litigation/admin/2011/33-9271.pdf> (“Pipeline Settlement”); In the Matter of INET ATS, Inc., Securities Exchange Act Release No. 53631 (Apr. 12, 2006), available at <https://www.sec.gov/litigation/admin/2006/34-53631.pdf> (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order); and In the Matter of BRUT, LLC, Securities Exchange Act Release No. 48718 (Oct. 30, 2003), available at <http://www.sec.gov/litigation/admin/34-48718.htm> (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order).

in connection with the NMS Stock ATS, to help market participants assess potential conflicts of interest that may adversely impact their trading on the NMS Stock ATS.

Finally, due to the overlap between the operation of NMS Stock ATSs and the other operations of broker-dealer operators, the Commission is concerned that market participants have limited information about how the operations of the broker-dealer operator's business units or its affiliates may give rise to information leakage of subscribers' confidential trading information among those business units or affiliates. For instance, if a proprietary trading desk of the broker-dealer operator is able to enter orders or other trading interest to the NMS Stock ATS, that trading desk may have means to see the incoming order flow of unaffiliated subscribers to the NMS Stock ATS. Furthermore, as demonstrated by several enforcement actions, a broker-dealer operator may at times provide some subscribers—including its business units or those of its affiliates—access to certain trading information that it does not provide to others.<sup>373</sup>

Accordingly, the Commission preliminarily believes that the disclosure of certain information about the activities of the broker-dealer operator and its affiliates with respect to the NMS Stock ATS would enable market participants to better assess whether the potential for information leakage exists. The Commission preliminarily believes that such disclosures would help a market participant independently evaluate whether submitting order flow to a particular NMS Stock ATS aligns with its business interests and would help it achieve its investing or trading objectives.

#### **B. Disclosures Required under Part III of Proposed Form ATS-N**

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<sup>373</sup> See *id.*

Part III of proposed Form ATS-N would require that broker-dealer operators of NMS Stock ATSs include, as applicable, disclosures that pertain to the broker-dealer operator and its affiliates of an NMS Stock ATS. The Commission preliminarily believes that these proposed disclosure requirements would help ensure that market participants and the Commission are adequately informed about: (1) the operation of the NMS Stock ATS—regardless of the corporate structure of the NMS Stock ATS and that of its broker-dealer operator, or any arrangements the broker-dealer operator may have made, whether contractual or otherwise, pertaining to the operation of its NMS Stock ATS; and (2) any potential conflicts of interest the broker-dealer operator may have with respect to the operation of its NMS Stock ATS.

The Commission has also considered other alternatives to address the potential conflicts of interest between NMS Stock ATSs and their broker-dealer operators.<sup>374</sup> For example, the Commission could require an NMS Stock ATS to operate as a “stand-alone” entity having no affiliation with any broker-dealer that seeks to execute proprietary or agency orders in the NMS Stock ATS. This alternative would eliminate any potential conflicts of interest by requiring a broker-dealer that operates an NMS Stock ATS to have only a single business function—operating the NMS Stock ATS—and eliminating any other functions, such as trading on a proprietary basis or routing customer orders. As another alternative, and short of requiring NMS Stock ATSs to operate on a stand-alone basis, the Commission could continue to permit broker-dealer operators to continue to act as a broker-dealer operator of an NMS Stock ATS and engage in non-ATS functions while imposing new requirements designed to limit potential conflicts.

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<sup>374</sup> See Section.XIII.D.7 for a further discussion of alternatives to address potential conflicts of interest.

The Commission preliminarily believes that the above alternatives could be significantly more intrusive and substantially affect or limit the current operations of ATSS that trade NMS stocks relative to requiring additional disclosures about the operations of the broker-dealer operator and its affiliates, and therefore is not proposing such alternatives at this time. The Commission is instead proposing that NMS Stock ATSS and their broker-dealer operators provide additional disclosures, both to the Commission and the public, about how they interact.

Request for Comment

149. Do you believe that it is necessary to have some understanding of the broader activities of the broker-dealer operator and its affiliates in order to understand and evaluate the operation of an NMS Stock ATS? Why or why not? Please support your arguments.
150. Do you believe that conflicts of interest could arise from a broker-dealer's operation of an NMS Stock ATS? Why or why not? If so, please explain what these conflicts of interest are. Do you believe that potential conflicts of interest should be disclosed to the public? Why or why not? Please support your arguments.
151. Do you believe that certain conflicts of interest arising out of the broker-dealer's operation of the NMS Stock ATS should be prohibited? Why or why not? Please support your arguments.
152. Do you believe that the Commission should adopt an alternative approach, either those described above or any other alternative, such as a prohibition, regarding potential conflicts of interest arising from a broker-dealer's operation of an NMS

Stock ATS? Why or why not? Please support your arguments. If so, what approach should the Commission adopt? Please be specific.

153. Do you believe that the Commission should require information barriers between the ATS and non-ATS business units of the broker-dealer operator? Why or why not? Please support your arguments.
154. Do you believe that the Commission should require an NMS Stock ATS to operate as a “stand-alone” entity and have no affiliation with any broker-dealer that seeks to execute proprietary or agency orders in the ATS? Why or why not? Please support your arguments. Do you believe that the proposed disclosures on Form ATS-N would help broker-dealers better assess whether the routing of their customers’ orders to a particular NMS Stock ATS fulfills the broker-dealer’s duty of best execution?<sup>375</sup> Why or why not? Please support your arguments.
155. Do you believe that the proposed disclosures on Form ATS-N would help customers of broker-dealers to better evaluate whether their broker-dealer is fulfilling its duty of best-execution with respect to orders routed to NMS Stock ATSS? Why or why not? Please support your arguments.

#### **1. Proposed Definitions of “Affiliate” and “Control”**

For the purposes of the proposed disclosures regarding affiliates of the broker-dealer operator, the Commission is proposing to define the term “affiliate” to mean “with respect to a specified person, any person that directly, or indirectly, controls, is under common control with,

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<sup>375</sup> See supra notes 36-40 and accompanying text (relating to the duty of best execution).

or is controlled by, the specified person.”<sup>376</sup> This proposed definition is consistent with the definition of an “affiliate” for the purposes of Form 1 disclosures,<sup>377</sup> and relates closely to the definition of a similar term under Regulation ATS.<sup>378</sup>

The Commission also proposes to amend the existing definition of the term “control” under Regulation ATS to add the phrase “the broker-dealer of” before the two instances of the phrase “an alternative trading system” and before the phrase “the alternative trading system” in subsections (2) and (3) of the definition.<sup>379</sup> As proposed to be amended, “control” would mean “the power, directly or indirectly, to direct the management or policies of the broker-dealer of an alternative trading system, whether through the ownership of securities, by contract, or otherwise. A person is presumed to control the broker-dealer of an alternative trading system, if that person (1) is a director, general partner, or officer exercising executive responsibility (or having similar status or performing similar functions); (2) directly or indirectly has the right to vote 25% or more of a class of voting securities or has the power to sell or direct the sale of 25% or more of a class of voting securities of the broker-dealer of the alternative trading system; or (3) in the case of a partnership, has contributed, or has the right to receive, upon dissolution, 25% or more of the capital of the broker-dealer of the alternative trading system.”<sup>380</sup> The purpose of these amendments to the definition of control under Regulation ATS is to make clear that,

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<sup>376</sup> See Instruction G to proposed Form ATS-N.

<sup>377</sup> See Instruction B to Form 1; 17 CFR 249.1.

<sup>378</sup> See 17 CFR 242.300(c) (defining affiliate of a subscriber as any person that, directly or indirectly, controls, is under common control with, or is controlled by, the subscriber, including any employee).

<sup>379</sup> 17 CFR 242.300(f).

<sup>380</sup> See *id.* and Instruction G to proposed Form ATS-N.

because an ATS must register as a broker-dealer, control of the broker-dealer of the ATS is control of the ATS, and that the broker-dealer (also referred to as the broker-dealer operator) is legally responsible for all operational aspects of the ATS and for ensuring that the ATS complies with applicable federal securities laws and the rules and regulations thereunder, including Regulation ATS.

The proposed disclosures of affiliate activities under Part III of proposed Form ATS-N are designed to provide market participants and the Commission with a comprehensive understanding of the potential conflicts of interest that may arise from the broker-dealer operator's other business activities and its operation of the NMS Stock ATS. Under the proposed definition of "affiliate" and amended definition of "control," any affiliate of the broker-dealer operator of the NMS Stock ATS would be an affiliate of the NMS Stock ATS.<sup>381</sup> The Commission preliminarily believes that the proposed definition of an "affiliate" and amended definition of "control" would cover entities that have a close relationship with the broker-dealer operator and whose activities could raise potential conflicts of interest, or could otherwise be relevant to market participants in evaluating an NMS Stock ATS. Extending the proposed disclosures to affiliates of the broker-dealer operator could also reduce the potential for an entity to structure its organization in a way that would not provide complete disclosure of information in response to Part III of proposed Form ATS-N. The Commission notes that the proposed disclosures related to affiliates extends to persons that control, are controlled by, or are under

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<sup>381</sup> The instructions in proposed Form ATS-N would require an NMS Stock ATS to provide the identity of affiliates and business units of the broker-dealer operator, provide the name under which each affiliate or business unit conducts business (e.g., the formal name under which a proprietary trading desk of the broker-dealer operator conducts business) and the applicable CRD number and MPID(s) under which the affiliate or business unit conducts business.

common control with the broker-dealer operator, and, as a result, parallels the disclosures related to “control affiliates” that are required in Form BD, to which broker-dealer operators are already subject.<sup>382</sup>

#### Request for Comment

156. Should the Commission adopt the proposal to define “affiliate” for purposes of proposed Form ATS-N as, with respect to a specified person, any person that, directly or indirectly, controls, is under common control with, or is controlled by, the specified person? Why or why not? Please support your arguments. Do you believe that the Commission should adopt a more limited or expansive definition of an “affiliate”? Why or why not? Please support your arguments. What advantages or disadvantages might result from a more limited or expansive definition of an affiliate? Please support your arguments.

157. Do you believe that the Commission should use the definition of an “affiliated person” as defined in the Exchange Act for purposes of proposed Rule 304?<sup>383</sup> Why or why not? Please support your arguments. If so, do you believe that the

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<sup>382</sup> See Form BD at 2 (defining “control affiliate”).

<sup>383</sup> Under the Exchange Act, an “affiliated person” of another person means: (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 percent or more of the outstanding voting securities of such other person; (B) any person 5 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof. 15 U.S.C. 78c(a)(19); 15 U.S.C. 80a-2(a)(3).

Commission should require disclosures about the activities of affiliated persons of the NMS Stock ATS, and/or affiliated persons of an affiliated person of an NMS Stock ATS? Why or why not? Please support your arguments.

158. Do you believe that the proposed amendments to the definition of “control” under Regulation ATS are appropriate in this context? Do you believe the Commission should adopt a more limited or expansive definition of “control”? Why or why not? Please support your arguments.
159. Do you believe the voting interest or partnership interest thresholds for “control” of an entity (i.e., 25% or more) should be higher or lower for purposes of Rule 304? For example, should the voting interest or partnership interest threshold for control of an entity to be presumed be 5%, 10%, 15%, 30%, or 50% for purposes of Rule 304? If so, what is the appropriate percentage threshold and why would such alternate percentage threshold be more appropriate? Please support your arguments.
160. Do you believe that the definition of “control” should deem an affiliate of the broker-dealer of the NMS Stock ATS to be an affiliate of the NMS Stock ATS, such that the ATS would be subject to all of the proposed disclosures relating these entities? Should the definition of “control” be amended? If so, how should it be amended? Please support your arguments.
161. Do you believe that the information required to be filed on proposed Form ATS-N about affiliates of the NMS Stock ATS would provide useful information to market participants? Why or why not? Please support your arguments.

162. Do you believe that the Commission should require that the MPID and/or CRD number for affiliates and business units of the broker-dealer operator be disclosed on proposed Form ATS-N? Would such disclosure help market participants identify the broker-dealer operator's affiliates and business units? Why or why not? Please support your arguments.

## 2. Non-ATS Trading Centers of the Broker-Dealer Operator

Part III, Item 1 of proposed Form ATS-N would require an NMS Stock ATS to disclose whether the broker-dealer operator or any of its affiliates operate or control any non-ATS trading center(s)<sup>384</sup> that is an OTC market maker or executes orders in NMS stocks internally by trading as principal or crossing orders as agent ("non-ATS trading centers"),<sup>385</sup> and if so, to (1) identify

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<sup>384</sup> A trading center is defined under Regulation NMS as a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent. 17 CFR 242.600(b)(78). The Commission preliminarily believes that the last two components of the definition of a trading center (*i.e.*, an OTC market maker and any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent) are the trading centers for which conflicts of interests of the broker-dealer operator and its affiliates are relevant, as such trading centers operate as competing venues for the execution of NMS stock over-the-counter.

<sup>385</sup> References to non-ATS trading centers, as used herein, encompass all executions that occur off of an exchange and outside of an ATS, including when a broker-dealer is acting as an OTC market-maker, block positioner (*i.e.*, any broker-dealer in the business of executing, as principal or agent, block size trades for its customers), or operation of an internal broker-dealer system. See 17 CFR 242.600(b)(52) (defining "OTC market maker" as any dealer that holds itself out as being willing to buy and sell to its customers, or others, in the United States, an NMS stock for its own account on a regular or continuous basis otherwise than on a national securities exchange in amounts of less than block size); 17 CFR 242.600(b)(9) (defining "block size" as an order of at least 10,000 shares or for a quantity of stock having a market value of at least \$200,000); and 17 CFR 240.17a-3(a)(16)(ii)(A) (defining "internal broker-dealer system" as any facility, other than a national securities exchange, an exchange exempt from registration based on limited volume, or an alternative trading system as defined in Regulation ATS that

the non-ATS trading center(s); and (2) describe any interaction or coordination between the identified non-ATS trading center(s) and the NMS Stock ATS including: (i) circumstances under which subscriber orders or other trading interest (such as quotes, indications of interest (“IOI”), conditional orders or messages (hereinafter collectively referred to as “trading interest”)) sent to the NMS Stock ATS are displayed or otherwise made known to the identified non-ATS trading center(s) identified in Item 1(a) before entering the NMS Stock ATS; (ii) circumstances under which subscriber orders or other trading interest received by the broker-dealer operator or its affiliates may execute, in whole or in part, in the identified non-ATS trading center identified in Item 1(a) before entering the NMS Stock ATS; and (iii) circumstances under which subscriber orders or other trading interest are removed from the NMS Stock ATS and sent to the identified non-ATS trading center(s).<sup>386</sup>

The Commission is aware that many broker-dealer operators of ATSs that currently trade NMS stocks facilitate the execution of NMS stock outside of their ATSs.<sup>387</sup> As discussed above, a broker-dealer operator is permitted to engage in broker or dealer activities independent of its operation of an ATS, such as operating proprietary trading desks; the proposed rules do not eliminate or otherwise restrict such activities. The Commission, however, is proposing to require

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provides a mechanism, automated in full or in part, for collecting, receiving, disseminating, or displaying system orders and facilitating agreement to the basic terms of a purchase or sale of a security between a customer and the sponsor, or between two customers of the sponsor, through use of the internal broker-dealer system or through the broker or dealer sponsor of such system). See also 2010 Equity Market Structure Release, supra note 124, at 3599-3600.

<sup>386</sup> See Part III, Item 1 of proposed Form ATS-N.

<sup>387</sup> See, e.g., Laura Tuttle, Over-the-Counter Trading: Description of Non-ATS OTC Trading in National Market System Stocks (March 2014), available at <http://www.sec.gov/dera/staff-papers/white-papers/otc-trading-white-paper-03-2014.pdf>.

the public disclosure on proposed Form ATS-N of such activities as they relate to the NMS Stock ATS. As noted above, the Commission preliminarily believes that circumstances could arise whereby a broker-dealer operator of an NMS Stock ATS may place the interests of its or its affiliates' non-ATS trading center ahead of the interests of the operations of the NMS Stock ATS and its subscribers. The Commission recognizes the sensitive nature of the confidential trading information of subscribers to an ATS and the potential for its misuse. The Commission preliminarily believes that non-ATS trading centers of a broker-dealer operator of an NMS Stock ATS or its affiliates may have incentives, and the opportunity to access, NMS Stock ATS subscriber orders received by the broker-dealer operator, which may result in information leakage.

Furthermore, the Commission preliminarily believes that subscribers to NMS Stock ATSS currently have limited information about the various non-ATS trading centers operated by an NMS Stock ATS broker-dealer operator, or its affiliates, and the extent to which the operations of these non-ATS trading centers may interact with subscriber orders or other trading interest sent to the NMS Stock ATS. Orders or other trading interest sent by subscribers to the NMS Stock ATS may pass through the broker-dealer operator's systems or functionality before being entered into the NMS Stock ATS. Such systems and functionalities, which could include a common gateway function, algorithm, or smart order router, may be used to support the broker-dealer operator's other business units, including any non-ATS trading centers. The broker-dealer operator typically controls the logic contained in these systems or functionality that determines where an order that the broker-dealer receives will be handled or sent. The Commission preliminarily believes that it would be helpful for NMS Stock ATS subscribers to know the extent to which subscriber orders received by the broker-dealer operator may interact, or be

handled in any coordinated manner, with a non-ATS trading center of that broker-dealer operator or its affiliates.<sup>388</sup> In addition, Form ATS-N would require the disclosure of circumstances under which subscriber orders or other trading interest received by the broker-dealer operator may execute, in whole or in part, in a non-ATS trading center(s) operated by the broker-dealer operator or its affiliates before entering the NMS Stock ATS; the circumstances under which subscriber orders or other trading interest would be displayed or otherwise made known to the systems or personnel operating the non-ATS trading center(s); and the circumstances under which subscriber orders or other trading interest are removed from the NMS Stock ATS and sent to the non-ATS trading center(s) for execution. To the extent that the broker-dealer operator or its affiliates operate a non-ATS trading center(s), but NMS Stock ATS subscribers' orders could not execute, route, or otherwise be shared with that non-ATS trading center(s), the NMS Stock ATS could note this fact in Part III, Item 1 of proposed Form ATS-N.

The disclosures in Part III, Item 1 of proposed Form ATS-N are designed to reduce information asymmetries between subscribers and the broker-dealer operator regarding the

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<sup>388</sup> As noted above, the Commission is aware that most of the broker-dealer operators of ATSS that currently trade NMS stocks also facilitate the execution of NMS stocks in non-ATS trading centers outside of the NMS Stock ATS. See *supra* note 362 and accompanying text. In October of 2013, the Commission and its staff estimated that about 16.99% of total dollar volume (18.75% of share volume) of NMS stocks is executed over-the-counter ("OTC") without the involvement of an ATS. In contrast, the Commission and its staff estimated that ATSS comprise 11.31% of total dollar volume (12.04% of share volume). See Tuttle: ATS Trading in NMS Stocks, *supra* note 126, at 2. Given that a greater percentage of OTC executions in NMS stock occur outside of ATSS rather than inside of ATSS, the Commission preliminarily believes that some disclosure of the presence of these non-ATS trading centers is appropriate. Accordingly, to the extent that an NMS Stock ATS subscriber's orders may execute, be displayed, or otherwise made known in a non-ATS trading center operated by or affiliated with the broker-dealer operator, the Commission preliminarily believes that disclosure of such possibility would be relevant to market participants in deciding whether to subscribe or route orders to a particular NMS Stock ATS.

operation of the NMS Stock ATS and competing venues for the execution of NMS stock transactions (i.e., non-ATS trading centers) that the broker-dealer operator operates and the circumstances in which the broker-dealer operator may handle or choose to execute subscriber orders outside of the NMS Stock ATS that might otherwise have been sent to the NMS Stock ATS.

Request for Comment

163. Do you believe the Commission should require the disclosure of the information on Part III, Item 1 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
164. Do you believe Part III, Item 1 of proposed Form ATS-N captures the information regarding non-ATS trading centers operated or controlled by the broker-dealer operator or any of its affiliates that is most relevant to understanding the operations of the NMS Stock ATS? Why or why not? Please support your arguments.
165. Do you believe there is other information that market participants might find relevant or useful regarding non-ATS trading centers operated or controlled by the broker-dealer operator or any of its affiliates? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
166. Do you believe that Part III, Item 1 of proposed Form ATS-N is sufficiently clear with respect to the disclosures that would be required? If not, how should Part III, Item 1 of proposed Form ATS-N be revised to provide additional clarity? Please explain in detail.

167. Do you believe that the non-ATS trading centers operated by the broker-dealer operator or its affiliates could raise potential conflicts of interest? Why or why not? If so, do you believe that such potential conflicts of interest should be disclosed? Please support your arguments.
168. Part III, Item 1 of proposed Form ATS-N would require disclosure about the non-ATS trading center activities of affiliates of the broker-dealer operator. Do you believe that disclosure about the activities of the broker-dealer operator's affiliates in this context is necessary? Why or why not? Should disclosure of non-ATS trading center activities extend to more remote affiliates under a revised definition of "affiliate"?<sup>389</sup> Should disclosure of non-ATS trading center activities apply to a more limited set of affiliates? Why or why not? Please support your arguments.
169. What are the potential costs and benefits of disclosing the information required by Part III, Item 1 of proposed Form ATS-N? Do you believe the proposed disclosures in Part III, Item 1 have the potential to impact innovation? Why or why not? Do you believe that the proposed disclosures in Part III, Item 1 of proposed Form ATS-N would require broker-dealer operators of NMS Stock ATSs to reveal too much (or not enough) information about their structure and operations? Why or why not? Please support your arguments.
170. Do you believe there is other information that market participants might find relevant or useful regarding the disclosure of non-ATS trading centers operated by the broker-dealer operator or its affiliates? If so, describe such information

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<sup>389</sup> See, e.g., supra note 383 and accompanying text.

and explain whether or not such information should be required to be provided under proposed Form ATS-N. Please support your arguments.

171. Do you believe there is any information regarding the non-ATS trading centers of the broker-dealer operator or its affiliates that should not be required to be disclosed on proposed Form ATS-N due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
172. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSS by Part III, Item 1 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part III, Item 1?

### **3. Multiple NMS Stock ATS Operations of the Broker-Dealer Operator**

Part III, Item 2 of proposed Form ATS-N would require an NMS Stock ATS to state whether the broker-dealer operator, or any of its affiliates, operates one or more NMS Stock ATSS other than the NMS Stock ATS named on the Form ATS-N, and, if so, to (1) identify the NMS Stock ATS(s) and provide its MPID(s); and (2) describe any interaction or coordination between the identified NMS Stock ATS(s) and the NMS Stock ATS named on the Form ATS-N including: (i) the circumstances under which subscriber orders or other trading interest received by the broker-dealer operator or its affiliates to be sent to the NMS Stock ATS named on the Form ATS-N may be sent to any identified NMS Stock ATS(s); (ii) circumstances under which subscriber orders or other trading interest to be sent to the NMS Stock ATS named on the Form ATS-N are displayed or otherwise made known in any other identified NMS Stock ATS(s); and

(iii) the circumstances under which subscriber orders or other trading interest received by the NMS Stock ATS named on the Form ATS-N may be removed and sent to any other identified NMS Stock ATS(s).<sup>390</sup>

The Commission is aware that some broker-dealer operators operate multiple ATSs that trade NMS stocks and that subscriber orders or other trading interest received by such broker-dealer operators could be routed between those NMS Stock ATSs. The Commission preliminarily believes that—similar to the potential conflicts of interest that may arise or information leakage that may occur when a broker-dealer operator, or its affiliate, operates or controls a non-ATS trading center—circumstances might arise whereby a broker-dealer that operates multiple NMS Stock ATSs may place its interests ahead of the interests of subscribers of one or more of its NMS Stock ATSs.<sup>391</sup> To the extent that the broker-dealer operator or its affiliates operate multiple NMS Stock ATSs, but the subscribers' orders of the NMS Stock ATS named in the Form ATS-N filing could not execute, route, be displayed, or otherwise made known to the NMS Stock ATS(s) identified in Item 2(a) of proposed Form ATS-N, the NMS Stock ATS could note this fact in Part III, Item 2 of proposed Form ATS-N.

Therefore, under Part III, Item 2 of proposed Form ATS-N, a broker-dealer operator that operates multiple NMS Stock ATSs would be required to disclose how these trading venues interact with one another, if at all. To the extent that a broker-dealer operator could allocate subscriber orders it receives among the various NMS Stock ATSs that it or its affiliates operate, the broker-dealer operator would be required to describe how it determines such allocation in

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<sup>390</sup> See Part III, Item 2 of proposed Form ATS-N.

<sup>391</sup> See supra note 366.

response to Item 2. For example, a broker-dealer operator may send all subscriber orders that it receives first to one of its NMS Stock ATSS, and if there is no execution after a certain period of time, the orders may then be routed directly to a second NMS Stock ATS operated by the broker-dealer operator or its affiliates, or may be returned to the broker-dealer operator (or its SOR or similar functionality), and may then be routed to a non-affiliated NMS Stock ATS for execution. Similarly, an NMS Stock ATS would be required to describe the circumstances under which subscriber orders on the NMS Stock ATS might be removed from the NMS Stock ATS and routed to another NMS Stock ATS that is operated by that broker-dealer operator or its affiliates.<sup>392</sup>

The Commission preliminarily believes that subscribers to NMS Stock ATSS currently have limited information about the extent to which the operations of other ATSS operated by the same broker-dealer operator, or its affiliates, may interact with their orders sent to the NMS Stock ATS. Specifically, because subscriber orders received by a broker-dealer operator could be sent to multiple NMS Stock ATSS operated by that broker-dealer operator, the Commission preliminarily believes that subscribers should be provided with a better understanding of how their orders may interact, if at all, with multiple NMS Stock ATSS operated by the same broker-dealer operator or its affiliates. The proposed disclosures in Part III, Item 2 of proposed Form ATS-N are designed to help subscribers evaluate potential conflicts of interest for the broker-dealer operator or the potential for information leakage in connection with multiple NMS Stock

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<sup>392</sup> As is the case with the proposed disclosures under Part III, Item 1 of proposed Form ATS-N in regard to non-ATS trading centers, Part III, Item 2 of proposed Form ATS-N would require an NMS Stock ATS to disclose whether any affiliates of the broker-dealer operator operates an NMS Stock ATS. This disclosure is designed to elicit certain information about the relationship of related NMS Stock ATSS, regardless of the organizational structure of the broker-dealer operator and its affiliates.

ATs that the broker-dealer operator, or its affiliates, operates.<sup>393</sup> Accordingly, the Commission preliminary believes that the disclosures required under Part III, Item 2 of proposed Form ATS-N would provide market participants with better information about how orders would be handled by a broker-dealer operator that operates multiple NMS Stock ATs and the potential conflicts of interest and potential for information leakage that might arise as a result of such a business structure.

Request for Comment

173. Do you believe the Commission should require the disclosure of the information on Part III, Item 2 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
174. Do you believe Part III, Item 2 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATs regarding any other NMS Stock ATs (other than the one named on the Form ATS-N) operated or controlled by the broker-dealer operator or any of its affiliates? Why or why not? Please support your arguments.
175. Do you believe that Part III, Item 2 of proposed Form ATS-N is sufficiently clear with respect to the disclosures that would be required? If not, how should Part III, Item 2 of proposed Form ATS-N be revised to provide additional clarity? Please explain.

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<sup>393</sup> The Commission notes that a broker-dealer operator may have valid business reasons for operating multiple NMS Stock ATs, and the Commission is not proposing to limit the ability for a broker-dealer operator to operate multiple NMS Stock ATs. For example, the broker-dealer operator may establish several NMS Stock ATs so that each NMS Stock AT offers subscribers specific trading services (block order executions) or other particular trading functionalities (e.g., an auction mechanism or a limit order book).

176. Do you believe that the operation of multiple NMS Stock ATSs by the broker-dealer operator or its affiliates could raise potential conflicts of interest? Why or why not? If so, do you believe that such potential conflicts of interest should be disclosed? Please support your arguments.
177. Do you believe that the information that would be solicited by Part III, Item 2 of proposed Form ATS-N would be useful to market participants in deciding whether to participate on an NMS Stock ATS? Why or why not? Please support your arguments.
178. Part III, Item 2 of proposed Form ATS-N would require disclosure of whether the affiliates of the broker-dealer operator operate an NMS Stock ATS (other than the NMS Stock ATS filing the Form ATS-N). Do you believe that disclosure about affiliates of the broker-dealer operator in this context is necessary? Why or why not? Should disclosure of affiliates that operate another NMS Stock ATS be extended to more remote affiliates under a revised definition of "affiliate"?<sup>394</sup> Should disclosure apply to a more limited set of affiliates? Why or why not? Please support your arguments.
179. What are the potential costs and benefits of disclosing the information required by Part III, Item 2 of proposed Form ATS-N? Do you believe the disclosures in Part III, Item 2 of proposed Form ATS-N would have the potential to impact innovation? Why or why not? Would the proposed disclosures in Part III, Item 2 of proposed Form ATS-N require broker-dealer operators of NMS Stock ATSs to

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<sup>394</sup> See, e.g., supra note 383 and accompanying text.

reveal too much (or not enough) information about their structure and operations?

Why or why not? Please support your arguments.

180. Do you believe there is other information that market participants might find relevant or useful regarding the operation of multiple NMS Stock ATSS by a broker-dealer operator or its affiliate? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
181. Do you believe that the Commission should require NMS Stock ATSS to disclose the names of any non-NMS stock ATSS that are operated by its broker-dealer operator or one of its broker-dealer operator's affiliates? Why or why not? If so, what information should the NMS Stock ATS be required to disclose about such non-NMS stock ATSS? Please support your arguments.
182. Do you believe there is any information regarding the multiple NMS Stock ATS operations of a broker-dealer operator that the NMS Stock ATS should not be required to disclose on proposed Form ATS-N due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please explain.
183. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSS by Part III, Item 2 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part III, Item 2?

#### **4. Products or Services Offered to Subscribers by the Broker-Dealer Operator**

Part III, Item 3 of proposed Form ATS-N would require an NMS Stock ATS to disclose whether the broker-dealer operator, or any of its affiliates, offer subscribers of the NMS Stock ATS any products or services used in connection with trading on the NMS Stock ATS (e.g., algorithmic trading products, market data feeds). If so, the NMS Stock ATS would be required to describe the products and services and identify the types of subscribers (e.g., retail, institutional, professional) to which such services or products are offered, and if the terms and conditions of the services or products are not the same for all subscribers, describe any differences.<sup>395</sup>

Based on the Commission's experience, broker-dealer operators of NMS Stock ATSs may, directly or indirectly through an affiliate, offer products or services to subscribers in addition to the trading services of the NMS Stock ATS. For example, a broker-dealer operator may offer subscribers the use of an order management system to allow them to connect to or send orders or other trading interest to the NMS Stock ATS. Some broker-dealer operators may also offer subscribers the use of algorithmic trading strategies, which are computer assisted trading tools that, for instance, may be used by or on behalf of institutional investors to execute orders that are typically too large to be executed all at once without excessive price impact, and divide the orders into many small orders that are fed into the marketplace over time.<sup>396</sup> In some cases, a broker-dealer operator offering products or services in connection with a subscriber's use of the NMS Stock ATS may result in the subscribers receiving more favorable terms from

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<sup>395</sup> See Part III, Item 3 of proposed Form ATS-N.

<sup>396</sup> See Staff of the Division of Trading and Markets, Commission, "Equity Market Structure Literature Review, Part II: High Frequency Trading," at 5 (March 18, 2014), [available at http://www.sec.gov/marketstructure/research/hft\\_lit\\_review\\_march\\_2014.pdf](http://www.sec.gov/marketstructure/research/hft_lit_review_march_2014.pdf).

the broker-dealer operator with respect to their use of the NMS Stock ATS. For example, if a subscriber purchases a service offered by the broker-dealer operator of an NMS Stock ATS, the broker-dealer operator might also provide that subscriber more favorable terms for their use of the NMS Stock ATS than other subscribers who do not purchase the service. Such favorable terms could include fee discounts or access to a faster connection line to the NMS Stock ATS. Additionally, a broker-dealer operator of an NMS Stock ATS may only offer certain products and services to certain subscribers or may offer products and services on different terms to different categories of subscribers. The Commission preliminarily believes that market participants would want to know, when assessing an NMS Stock ATS as a potential trading venue, the range of services or products that the broker-dealer operator or its affiliates may offer subscribers of the NMS Stock ATS because such services or products may have an impact on the subscribers' access to, or trading on, the NMS Stock ATS.

Request for Comment

184. Do you believe the Commission should require the disclosure of the information on Part III, Item 3 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
185. Do you believe Part III, Item 3 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS regarding other products or services offered to subscribers used in connection with trading on the NMS Stock ATS by the broker-dealer operator or any of its affiliates? Why or why not? Please support your arguments.
186. Do you believe that Part III, Item 3 of proposed Form ATS-N is sufficiently clear with respect to the disclosures that would be required? If not, how should Part III,

Item 3 of proposed Form ATS-N be revised to provide additional clarity? Please explain in detail.

187. Do you believe there is other information that market participants might find relevant or useful regarding other products and services offered to subscribers by broker-dealer operators or their affiliates? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
188. Do you believe that the Commission should expand the proposed disclosures in Part III, Item 3 of proposed Form ATS-N to products or services offered by the broker-dealer operator or its affiliates that are offered to subscribers, but not necessarily offered in connection with transacting on the NMS Stock ATS? Why or why not? Please explain. Do you believe there is other information that market participants might find useful regarding the products or services offered to subscribers by the broker-dealer operator or its affiliates? If so, what information should be added to the disclosure requirements? Please explain.
189. What are the potential costs and benefits of disclosing the information required by Part III, Item 3 of proposed Form ATS-N? Do you believe the disclosures in Part III, Item 3 of proposed Form ATS-N would have the potential to impact innovation? Why or why not? Would the proposed disclosures in Part III, Item 3 of proposed Form ATS-N require broker-dealer operators of NMS Stock ATSS to reveal too much (or not enough) information about their structure and operations? Why or why not? Please support your arguments.

190. Do you believe there is any information regarding the products or services offered to subscribers by the broker-dealer operator that the NMS Stock ATS should not be required to disclose on proposed Form ATS-N due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
191. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part III, Item 3 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part III, Item 3?

#### **5. Broker-Dealer Operator Arrangements with Unaffiliated Trading Centers**

Part III, Item 4 of proposed Form ATS-N would require an NMS Stock ATS to disclose whether the broker-dealer operator or any of its affiliates have any formal or informal arrangement with an unaffiliated person(s), or affiliate(s) of such person, that operates a trading center<sup>397</sup> regarding access to the NMS Stock ATS, including preferential routing arrangements. If so, the NMS Stock ATSs would be required to identify the person(s) and the trading center(s) and to describe the terms of the arrangement(s).<sup>398</sup>

Part III, Item 4 of proposed Form ATS-N is designed to inform subscribers and the Commission about arrangements that may impact a subscriber's experience on the NMS Stock ATS and allow market participants to evaluate potential conflicts of interest of the broker-dealer

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<sup>397</sup> See supra note 384 (defining trading center).

<sup>398</sup> See Part III, Item 4 of proposed Form ATS-N.

operator. For example, Part III, Item 4 of proposed Form ATS-N would require an NMS Stock ATS to disclose whether its broker-dealer operator has any arrangement with another unaffiliated NMS Stock ATS pursuant to which the NMS Stock ATS would route orders or other trading interest to the unaffiliated NMS Stock ATS for possible execution prior to routing to any other destination. Similarly, Part III, Item 4 of proposed Form ATS-N would require disclosure of an arrangement pursuant to which any subscriber orders routed out of the unaffiliated NMS Stock ATS would be routed first to the NMS Stock ATS before any other trading center, and would also require disclosure of the terms of the arrangement, for example, whether the NMS Stock ATS was providing monetary compensation or some other brokerage service to the unaffiliated NMS Stock ATS in exchange for the order flow.<sup>399</sup>

The Commission preliminarily believes that market participants would consider information about any arrangements between a broker-dealer operator of an NMS Stock ATS and other trading centers relevant to their evaluation of an NMS Stock ATS as a potential trading venue. The disclosure of such arrangements could reveal potential conflicts of interest of the broker-dealer operator or could identify potential sources of information leakage. For example, a potential conflict of interest could arise where an NMS Stock ATS has a preferred routing arrangement with an unaffiliated non-ATS trading center that provides that all orders sent to the NMS Stock ATS would first be routed to the unaffiliated non-ATS trading center before entering the NMS Stock ATS in exchange for monetary compensation. Such an arrangement could also

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<sup>399</sup> The Commission notes that a broker-dealer operator may have valid business reasons for it or its affiliates to have formal or informal arrangements with an unaffiliated person(s), or affiliate(s) of such person, that operates a trading center regarding access to the NMS Stock ATS. The Commission is not proposing to limit the ability for a broker-dealer operator to have such arrangements.

pose a risk of information leakage in that the non-ATS trading center would know that those orders that it does not execute would be routed to the NMS Stock ATS.<sup>400</sup> Part III, Item 4 of proposed Form ATS-N would also require disclosure of mutual access arrangements between an NMS Stock ATS and other trading centers whereby, for example, a broker-dealer operator or its affiliates may offer access to its NMS Stock ATS in exchange for access to the NMS Stock ATS of another broker-dealer operator.

The Commission notes that an NMS Stock ATS would not be prohibited from establishing arrangements with other trading centers, provided that such arrangements comply with other applicable laws and rules, including applicable federal securities laws and Regulation ATS. However, the Commission preliminarily believes that market participants could benefit from disclosures about such arrangements and would use such information when determining whether to subscribe, or route orders, to a particular NMS Stock ATS. Additionally, the Commission preliminarily believes that disclosure of such arrangements would help the Commission perform its oversight functions by enabling it to better evaluate an NMS Stock ATS's compliance with the requirements of Regulation ATS, such as Rule 301(b)(10).

#### Request for Comment

192. Do you believe the Commission should require the disclosure of the information on Part III, Item 4 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.

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Alternatively, if an arrangement between the NMS Stock ATS and unaffiliated trading center provided that any subscriber orders routed out of the NMS Stock ATS would be first routed to the unaffiliated non-ATS trading center, the NMS Stock ATS may have an incentive to remove subscribers' orders from the NMS Stock ATS and allow the unaffiliated non-ATS trading center the opportunity to execute those orders.

193. Do you believe Part III, Item 4 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS regarding any formal or informal arrangement by the broker-dealer operator or any of its affiliates with an unaffiliated person(s), or affiliate(s) of such person, that operates a trading center<sup>401</sup> regarding access to the NMS Stock ATS, including preferential routing arrangements? Why or why not? Please support your arguments.
194. Do you believe that Part III, Item 4 of proposed Form ATS-N is sufficiently clear with respect to the disclosures that would be required relating to access arrangements and preferred routing arrangements with other unaffiliated trading centers? If not, how should Part III, Item 4 of proposed Form ATS-N be revised to provide additional clarity? Please explain.
195. What are the potential costs and benefits of disclosing the information required by Part III, Item 4 of proposed Form ATS-N? Do you believe the disclosures in Part III, Item 4 of proposed Form ATS-N would have the potential to impact innovation? Why or why not? Would the proposed disclosures in Part III, Item 4 of proposed Form ATS-N require broker-dealer operators of NMS Stock ATSs to reveal too much (or not enough) information about their structure and operations? Why or why not? Please support your arguments.
196. Do you believe that the Commission should include access arrangements of affiliates of the broker-dealer operator in Part III, Item 4 of proposed Form ATS-

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<sup>401</sup> See supra note 384 (defining trading center).

N? Why or why not? Please support your arguments. Conversely, should disclosures of arrangements with other trading centers by affiliates be extended to more remote affiliates under a revised definition of “affiliate”?<sup>402</sup> Should disclosure apply to a more limited set of affiliates? Why or why not? Please support your arguments.

197. Do you believe that the Commission should expand the proposed disclosure requirements to other arrangements beyond access and preferred routing that the broker-dealer operator or its affiliates might have with other trading centers? If so, what other arrangements do you believe should be disclosed? Please explain in detail.
198. Do you believe that the Commission should limit or expand in any way the proposed disclosure requirements to require disclosure of arrangements regarding access by the broker-dealer operator or its affiliates to both other trading centers and affiliates of those other trading centers? Why or why not? Please support your arguments.
199. Do you believe there is other information that market participants might find relevant or useful regarding the broker-dealer operator or its affiliates’ arrangements with other trading centers? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.

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<sup>402</sup> See, e.g., supra note 383 and accompanying text.

200. Do you believe there is any information regarding the broker-dealer operator or its affiliates' arrangements with other trading centers that the NMS Stock ATS should not be required to disclose on proposed Form ATS-N due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.

201. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part III, Item 4 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part III, Item 4?

**6. Trading on the NMS Stock ATS by the Broker-Dealer Operator and its Affiliates**

Part III, Item 5 of proposed Form ATS-N would require certain disclosures related to the trading activity of the broker-dealer operator or its affiliates on the NMS Stock ATS.

Specifically, Part III, Item 5 of proposed Form ATS-N would require the NMS Stock ATS to disclose whether the broker-dealer operator, or any of its affiliates, enters orders or other trading interest on the NMS Stock ATS. If so, the NMS Stock ATS would be required to: (1) identify each affiliate and business unit of the broker-dealer operator that may enter orders or other trading interest on the NMS Stock ATS; (2) describe the circumstances and capacity (e.g., proprietary, agency) in which each identified affiliate and business unit enters orders or other trading interest on the NMS Stock ATS; (3) describe the means by which each identified affiliate and business unit enters orders or other trading interest on the NMS Stock ATS (e.g., directly through a FIX connection to the NMS Stock ATS, or indirectly, by way of the broker-dealer operator's SOR (or similar functionality), algorithm, intermediate application, or sales desk); and

(4) describe any means by which a subscriber can be excluded from interacting or trading with orders or other trading interest of the broker-dealer operator or its affiliates on the NMS Stock ATS.<sup>403</sup>

As noted above, Part III, Item 5(a) of proposed Form ATS-N would require the NMS Stock ATS to identify each affiliate and business unit (e.g., a sales desk or proprietary trading unit) and affiliate of the broker-dealer operator that can enter orders or other trading interest on the NMS Stock ATS. The Commission preliminarily believes that disclosure of whether a broker-dealer operator of an NMS Stock ATS or its affiliates may trade on that NMS Stock ATS would be important to subscribers with respect to the potential conflicts of interest that may arise from the unique position the broker-dealer operator occupies in relation to the NMS Stock ATS. If the person that operates and controls a trading center is also able to trade on that trading center, there may be an incentive to design the operations of the trading center to favor the trading activity of the operator of the trading center or affiliates of the operator.<sup>404</sup> The operator of a trading center that also trades on the trading center it operates would likely have informational advantages over others trading on the trading center such as a better understanding of the manner in which the system operates or who is trading on the trading center. In the most egregious case, the operator of the trading center might use the confidential trading information of other traders to advantage its own trading on that trading center, which, in context of an ATS, would violate Rule 301(b)(10). Accordingly, the Commission believes that subscribers would

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<sup>403</sup> The Commission notes that a broker-dealer operator may have valid business reasons for it or its affiliates to trade on the NMS Stock ATS. The Commission is not proposing to limit the ability for a broker-dealer operator to trade on any such NMS Stock ATS.

<sup>404</sup> See supra note 368 and accompanying text.

benefit from knowing whether and how a broker-dealer operator or its affiliates trade on the NMS Stock ATS to which they may route orders or become a subscriber. Such information would allow market participants to evaluate the extent of the potential conflicts of interest posed by the broker-dealer operator or its affiliates' participation on the NMS Stock ATS and to inquire further about such trading activity if they choose.

Part III, Item 5(b) of proposed Form ATS-N would require an NMS Stock ATS to disclose the circumstances and capacity in which the broker-dealer operator's business units or affiliates may trade on the NMS Stock ATS, such as whether they are trading on a proprietary basis (*i.e.*, for their own accounts) or agency basis or both. This disclosure is meant to provide insight as to the nature of the trading of the broker-dealer operator and/or its affiliates. The Commission preliminarily believes that market participants would find this information useful in evaluating NMS Stock ATSs because they may perceive agency trading by the broker-dealer operator or its affiliates as posing less of a conflict of interest as compared to proprietary trading. For example, market participants may perceive a lesser potential for a conflict of interest if the broker-dealer operator discloses that the broker-dealer operator or its affiliates trade on its own NMS Stock ATS only in an agency capacity with its customers' orders as opposed to trading on the NMS Stock ATS in a principal capacity on a proprietary basis—where the broker-dealer operator or its affiliates may have increased incentives to use their informational advantage in operating the NMS Stock ATS to advance their trading opportunities.<sup>405</sup> Alternatively, market participants could conclude that the broker-dealer operator's agency trading on its own NMS Stock ATS could nevertheless pose an unacceptable conflict of interest as the broker-dealer

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See supra note 366.

operator may be able to advantage its customers' orders to the disadvantage of subscribers to the NMS Stock ATS. The Commission proposes to provide market participants with information regarding the nature of the trading activity of the broker-dealer operator and its affiliates on the NMS Stock ATS so that subscribers (and potential subscribers) can evaluate potential conflicts of interest that may arise from that trading activity.

Part III, Item 5(c) of proposed Form ATS-N would require an NMS Stock ATS to describe the means by which the business units of the broker-dealer operator and its affiliates enter orders or other trading interest into the NMS Stock ATS. Item 5(d) would require a description of any means by which a subscriber can be excluded from interacting or trading with orders or other trading interest of the broker-dealer operator or its affiliates. Some NMS Stock ATSs that currently transact in NMS stocks may provide both direct and indirect means for subscribers to enter orders or other trading interest to the ATS. Based on its experience, the Commission understands that subscribers to some NMS Stock ATSs may enter orders or other trading interest directly to the ATS using, for example, a direct FIX connection,<sup>406</sup> while other subscribers may enter orders or other trading interest indirectly to the ATS using, for example, an algorithm, the broker-dealer operator's smart order router,<sup>407</sup> or the broker-dealer operator's sales desks. As such, there are a variety of means by which business units of the broker-dealer operator or its affiliates of the broker-dealer operator may connect to, and enter orders on, an

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<sup>406</sup> To the extent that a subscriber to the NMS Stock ATS directly sends an order to the NMS Stock ATS by way of FIX protocol, the NMS Stock ATS should identify and describe any intermediate functionality that the subscriber order may pass through on its way to the NMS Stock ATS as part of the FIX process.

<sup>407</sup> See *infra* Section VII.B.7 (discussing the use of smart order routers by broker-dealer operators of NMS Stock ATSs).

NMS Stock ATS. The Commission preliminarily believes that market participants evaluating NMS Stock ATSs may find this information relevant in assessing any potential advantages that the broker-dealer operator or its affiliates may have over other subscribers to the NMS Stock ATS. For example, an NMS Stock ATS may permit orders or other trading interest of all of its affiliates that trade on the NMS Stock ATS to enter through a means that can be used only by the broker-dealer operator or its affiliates and not by non-affiliated subscribers to the NMS Stock ATS (e.g., bypassing the broker-dealer operator's SOR). The Commission preliminarily believes that market participants would want to know these circumstances, as the difference in access or order entry could result in certain advantages, such as the speed at which orders could be entered or cancelled. Moreover, the Commission preliminarily believes that based on how a broker-dealer operator's business units or affiliates access and trade on an NMS Stock ATS—or on other considerations—certain subscribers may not wish to interact with the order flow of the broker-dealer operator or its affiliates. Accordingly, the Commission preliminarily believes that it is important for market participants to have the information to elect whether and how they may avoid trading against orders or other trading interest of the broker-dealer operator or its affiliates on an NMS Stock ATS to achieve their investing or trading objectives.

Overall, the Commission preliminarily believes that the disclosures required under Part III, Item 5 of proposed Form ATS-N would be useful to many market participants. The Commission notes that market participants may vary widely in their decision making process in selecting a particular trading center to effect their trades or route their orders, and therefore, the Commission preliminarily believes that some market participants may not be concerned with the potential conflicts of interest posed by the trading activity of the broker dealer operator or its affiliates on the NMS Stock ATS. However, absent disclosure of this trading activity of the

broker-dealer operator or its affiliates, subscribers and potential subscribers that take such information into account when executing their trading or investment strategies likely would neither be aware of such potential conflicts nor able to assess whether the conflicts might impact those strategies. Consequently, the Commission preliminarily believes that it would be useful to market participants for an NMS Stock ATS to be required to disclose the information required in Part III, Item 5 of proposed Form ATS-N.

Request for Comment

202. Do you believe the Commission should require the disclosure of the information on Part III, Item 5 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
203. Do you believe Part III, Item 5 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to the trading activity of the broker-dealer operator or its affiliates on the NMS Stock ATS? Why or why not? Please support your arguments.
204. Do you believe that Part III, Item 5 of proposed Form ATS-N is sufficiently clear with respect to the disclosures that would be required relating to the broker-dealer operator and its affiliates trading on the NMS Stock ATS? If not, how should Part III, Item 5 of proposed Form ATS-N be revised to provide additional clarity? Please explain.
205. Do you believe proposed disclosures in Part III, Item 5 of proposed Form ATS-N should be applied to the trading activity on the NMS Stock ATS of affiliates of the broker-dealer operator? Why or why not? Should disclosures of affiliates trading on the NMS Stock ATS be extended to more remote affiliates under a

revised definition of “affiliate”?<sup>408</sup> Should disclosures apply to a more limited set of affiliates? Why or why not? Please support your arguments.

206. Do you believe that the Commission should enhance measures to prevent potential conflicts of interest posed by the broker-dealer operator or its affiliates trading on its own NMS Stock ATS, such as prohibiting proprietary trading by the broker-dealer operator or its affiliates on the NMS Stock ATS? If no, why? If yes, what measures should the Commission consider? Please explain in detail.
207. What are the potential costs and benefits of disclosing the information required by Part III, Item 5 of proposed Form ATS-N? Do you believe the disclosures in Part III, Item 5 of proposed Form ATS-N would have the potential to impact innovation or discourage broker-dealer operators or their affiliates from trading on their own NMS Stock ATS? Why or why not? Would the proposed disclosures in Part III, Item 5 of proposed Form ATS-N require broker-dealer operators of NMS Stock ATSs to reveal too much (or not enough) information about their structure and operations? Why or why not? Please support your arguments.
208. Do you believe there is other information that market participants might find relevant or useful regarding the trading activity on the NMS Stock ATS by the broker-dealer operator or its affiliates? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.

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See, e.g., supra note 383 and accompanying text.

209. Do you believe there is any information regarding the trading activity on the NMS Stock ATS by the broker-dealer operator or its affiliates that the NMS Stock ATS should not be required to disclose on Form ATS-N due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
210. Should the Commission require separate disclosures for different types of trading conducted by the broker-dealer operator on the NMS Stock ATS, such as trading by the broker-dealer operator for the purpose of correcting error trades executed on the ATS, as compared to other types of proprietary trading? Why or why not? Please support your arguments. If so, what types of proprietary trading should be addressed separately and why? What disclosures should the Commission require about these types of proprietary trading and why? Please explain in detail.
211. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part III, Item 5 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part III, Item 5?

**7. Broker-Dealer Operator Smart Order Routers (or Similar Functionalities) and Algorithms**

Part III, Item 6 of proposed Form ATS-N would require the NMS Stock ATS to disclose whether the broker-dealer operator, or any of its affiliates, use a SOR(s) (or similar functionality), an algorithm(s), or both to send or receive subscriber orders or other trading interest to or from the NMS Stock ATS, and if so, to: (1) identify the SOR(s) (or similar

functionality) or algorithm(s) and identify the person(s) that operates the SOR(s) (or similar functionality) or algorithm(s), if other than the broker-dealer operator,<sup>409</sup> and (2) describe the interaction or coordination between the identified SOR(s) (or similar functionality) or algorithm(s) and the NMS Stock ATS, including any information or messages about orders or other trading interest (e.g., IOIs) that the SOR(s) (or similar functionality) or algorithm(s) send or receive to or from the NMS Stock ATS and the circumstances under which such information may be shared with any person.

Today, most broker-dealers that operate an NMS Stock ATS use some form of SOR (or similar functionality) in connection with the NMS Stock ATS. A SOR (or similar functionality) can generally be understood as an automated system used to route orders or other trading interest among trading centers, including proprietary non-ATS trading centers operated by the broker-dealer operator, to carry out particular trading instructions or strategies of a broker-dealer. Smart order routers (or similar functionalities) have become an integral part of the business of many multi-service broker-dealers, given the increase in the speed of trading in today's equity markets and the large number of trading centers, including national securities exchanges, ATSs, and non-ATS trading centers, that have emerged since the adoption of Regulation ATS. In addition to the SOR (or similar functionality), orders or other trading interest may be entered on an NMS Stock ATS through the use of a trading algorithm, which is a computer assisted trading tool that, for instance, may be used by or on behalf of institutional investors to execute orders that are

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See supra note 360.

typically too large to be executed all at once without excessive price impact, and divide the orders into many small orders that are fed into the marketplace over time.<sup>410</sup>

Broker-dealer operators of NMS Stock ATSS or their affiliates may use SORs (or similar functionality) or algorithms in a variety of ways.<sup>411</sup> For example, the broker-dealer operator may use the SOR (or similar functionality) to route orders on behalf of its customers and proprietary trading desks to different trading venues, or the broker-dealer operator may use the SOR as the primary means of routing subscriber orders or other trading interest to or from the NMS Stock ATS. The Commission understands, based on experience, that for some ATSS that currently transact in NMS stocks, the SOR (or similar functionality) or algorithm of the broker-dealer operator or its affiliates is the only means of access (*i.e.*, all orders or other trading interest entered on, or removed from, the ATS, must pass through the SOR (or similar functionality) or algorithm). A broker-dealer operator may also use a SOR (or similar functionality) or algorithm to handle all order flow received by the broker-dealer operator (or its affiliates), including both orders that a subscriber has specifically directed to the NMS Stock ATS and orders that may not be sent to the NMS Stock ATS, as well as the broker-dealer's own proprietary orders and those of its affiliates. For many orders, the SOR (or similar functionality) or algorithm determines

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<sup>410</sup> See Staff of the Division of Trading and Markets, Commission, "Equity Market Structure Literature Review, Part II: High Frequency Trading," at 5 (March 18, 2014), [available at http://www.sec.gov/marketstructure/research/hft\\_lit\\_review\\_march\\_2014.pdf](http://www.sec.gov/marketstructure/research/hft_lit_review_march_2014.pdf).

<sup>411</sup> The Commission notes that, similar to legacy NMS Stock ATSS, broker-dealer operators are likely to vary in their organizational structures. Accordingly, the Commission proposes to include affiliates of the broker-dealer operator that may operate a SOR(s) (or similar functionality) or algorithm(s) in Part III, Item 6 of proposed Form ATS-N to ensure that SORs (or similar functionalities) or algorithms used in connection with the NMS Stock ATSS are disclosed regardless of whether the SOR(s) (or similar functionality) or algorithm(s) is operated by an affiliate of the broker-dealer operator.

whether to route the order to the NMS Stock ATS, another NMS Stock ATS or non-ATS trading center operated by the broker-dealer operator, another broker-dealer, an unaffiliated NMS Stock ATS, or a national securities exchange. The SOR (or similar functionality) may obtain knowledge of subscriber orders or other trading interest that have been routed to the NMS Stock ATS (and may now be resting on the NMS Stock ATS) and subscriber orders that have been routed out of the NMS Stock ATS. Similarly, the system operating an algorithm used by the broker-dealer operator to enter subscriber orders based on the algorithm's trading strategy may obtain information about subscriber orders sent to the NMS Stock ATS. The broker-dealer operator (or its affiliates) programs and operates the SOR (or similar functionality) and/or algorithm(s), unless the broker-dealer operator contracts such functions to a third-party vendor, in which case the broker-dealer operator or third-party vendor may have access to information that passes through the SOR(s) (or similar functionality), algorithm(s) or both.

The Commission preliminarily believes that the high likelihood that a SOR (or similar functionality) or algorithm could access subscribers' confidential trading information necessitates disclosure of certain information to subscribers about the use of a SOR (or similar functionality) or algorithm by the broker-dealer operator or its affiliates to route subscriber orders to or out of the NMS Stock ATS. The Commission preliminarily believes that subscribers and the Commission would benefit from increased disclosures about the use of a SOR(s) (or similar functionality) or algorithm(s) by the broker-dealer operator or its affiliates in connection with the NMS Stock ATS because of the potential for information leakage. Existing Form ATS does not specifically inquire about the use of a SOR (or similar functionality) or algorithms in connection with an ATS and based on Commission experience, the Commission is concerned that there is limited information available to subscribers about the interaction between SORs (or

similar functionalities) or algorithms and affiliated ATSS that trade NMS stocks, despite the importance of SORs (or similar functionality) or algorithms to the functions and operations of such ATSS. The Commission preliminarily believes that information provided on Form ATS-N would allow market participants to better understand the operation of an NMS Stock ATS and the circumstances that may give rise to potential conflicts of interest and information leakage.

Part III, Item 6(a) of proposed Form ATS-N would require an NMS Stock ATS to identify the SOR(s) (or similar functionality) or algorithm(s) and identify the person(s) that operates the SOR (or similar functionality) and algorithm(s). Part III, Item 6(a) of proposed Form ATS-N is designed to provide subscribers with information about who operates the SOR(s) (or similar functionality) or algorithm(s) used in connection with the NMS Stock ATS, which would thereby inform subscribers about who may have access to their confidential trading information or control over the entry and removal of orders or other trading interest to and from the NMS Stock ATS. Information about the persons who operate a SOR(s) (or similar functionality) or algorithm(s) used in connection with the NMS Stock ATS and how the SOR(s) (or similar functionality) or algorithm(s) operates would allow subscribers to assess potential sources of information leakage and conflicts of interest that may arise from the operation of the SOR(s) (or similar functionality) and/or algorithm(s).

Part III, Item 6(b) of proposed Form ATS-N would require an NMS Stock ATS to describe the interaction or coordination between the identified SOR(s) (or similar functionality) or algorithm(s) and the NMS Stock ATS, including any information or messages about orders or other trading interest (e.g., IOIs) that the SOR(s) (or similar functionality) or algorithm(s) send or receive to or from the NMS Stock ATS and the circumstances under which such information may be shared with any person. Because the SOR(s) (or similar functionality) or algorithm(s)

and NMS Stock ATS are typically operated by the same broker-dealer operator (rather than a third-party vendor), the Commission preliminarily believes subscribers to the NMS Stock ATS are likely to find it important to understand what information about their orders is obtained by a SOR(s) (or similar functionality) or algorithm(s) and the circumstances under which that information may be used by the broker-dealer operator of the NMS Stock ATS, its affiliates, or other persons. The Commission is concerned that without this information, subscribers that send orders to the NMS Stock ATS by way of the broker-dealer operator's SOR (or similar functionality) or algorithm may not be able to understand the conditions under which information about their confidential trading information may be leaked.

The interaction or coordination of the SOR(s) (or similar functionality) or algorithm(s) with the NMS Stock ATS likely varies across NMS Stock ATSS. For instance, a SOR (or similar functionality) or algorithm may check for potential contra-side interest in a particular symbol on the NMS Stock ATS prior to sending the subscriber order or other trading interest into the NMS Stock ATS. Such protocol carried out by the SOR (or similar functionality) or algorithm may send only information about the symbol and side (i.e., buy or sell) of the subscriber's order or other trading interest, but not the size, price, identity of the subscriber or other information. As another example, an NMS Stock ATS that uses IOIs as part of its platform may use its SOR (or similar functionality) or an algorithm to facilitate the sending of IOIs to relevant persons regarding orders or other trading interest resting on the NMS Stock ATS. The Commission preliminarily believes that the operations and functions of the SOR(s) (or similar functionality) or algorithm(s) in these examples would be relevant to subscribers and helpful in understanding how the NMS Stock ATS operates.

The Commission notes that an ATS may consist of various functionalities or mechanisms that operate collectively as a Rule 3b-16 system to bring together the orders for securities of multiple buyers and sellers using non-discretionary methods.<sup>412</sup> Based on Commission experience, most broker-dealer operators that use a SOR(s) (or similar functionality) or algorithm operate the SOR(s) (or similar functionality) or algorithm(s) separate and apart from their ATS. However, to the extent that a SOR (or similar functionality) or algorithm operates jointly with, or performs a function of, the NMS Stock ATS to bring together the orders for securities of multiple buyers and sellers using established nondiscretionary methods, the SOR (or similar functionality) or algorithm may be considered part of the NMS Stock ATS.<sup>413</sup> For example, a SOR (or similar functionality) or algorithm that is, based on the facts and circumstances, the exclusive means for subscribers to access and enter orders or other trading interest on NMS Stock ATS for execution would be regarded as part of the operations of the

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<sup>412</sup> Under Rule 3b-16 an organization, association, or group of persons shall be considered to constitute, maintain, or provide “a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange,” if such organization, association, or group of persons: (1) brings together the orders for securities of multiple buyers and sellers; and (2) uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade. 17 CFR 240.3b-16(a).

<sup>413</sup> The Commission noted in adopting Regulation ATS that the Commission “will attribute the activities of a trading facility to a system if that facility is offered by the system directly or indirectly” and “if an organization arranges for separate entities to provide different pieces of a trading system, which together meet the definition contained in paragraph (a) of Rule 3b-16, the organization responsible for arranging the collective efforts will be deemed to have established a trading facility.” See Regulation ATS Adopting Release, *supra* note 7, at 70852. If the SOR(s) (or similar functionality) or algorithm(s) were operated by an affiliate of the NMS Stock ATS or an entity unaffiliated with the NMS Stock ATS, the SOR(s) (or similar functionality) or algorithm(s) could still be considered a part of the NMS Stock ATS depending on the facts and circumstances.

NMS Stock ATS because the SOR (or similar functionality) or algorithm would function as the mechanism for orders or other trading interest to be brought together and interact in the NMS Stock ATS. The Commission preliminarily believes that information provided on proposed Form ATS-N about the use of a SOR (or similar functionality) or algorithm under Part III, Item 6 of proposed Form ATS-N would allow the Commission to better understand the operations and scope of the NMS Stock ATS. That is, the proposed disclosures would assist the Commission in determining if a SOR (or similar functionality) or algorithm is facilitating the bringing together of orders for securities of multiple buyers and sellers using established nondiscretionary methods, and would consequently be part of the NMS Stock ATS for the purposes of Regulation ATS.

Request for Comment

212. Do you believe the Commission should require the disclosure of the information on Part III, Item 6 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
213. Do you believe Part III, Item 6 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS regarding the use of a SOR or algorithm by the broker-dealer operators, or any of its affiliates, to send or receive subscriber orders or other trading interest to or from the NMS Stock ATS? Why or why not? Please support your arguments.
214. Do you believe that Part III, Item 6 of proposed Form ATS-N is sufficiently clear with respect to the disclosures that would be required relating to the broker-dealer

operator and its affiliates' use of SORs (or similar functionality) and algorithms in connection with the NMS Stock ATS? If not, how should Part III, Item 6 of proposed Form ATS-N be revised to provide additional clarity? Please explain in detail.

215. Do you believe it is appropriate for the Commission to require disclosure about the use of SORs (or similar functionalities) and algorithms by the broker-dealer operator, or its affiliates, to send or receive orders or other trading interest to or from the NMS Stock ATS? Why or why not? Please support your arguments. If so, what level of detail should be disclosed about how SORs (or similar functionalities) and algorithms determine whether to send or receive orders or other trading interest to the NMS Stock ATS? Please be specific.
216. What are the potential costs and benefits of disclosing the information required by Part III, Item 6 of proposed Form ATS-N? Do you believe the disclosures in Part III, Item 6 of proposed Form ATS-N would have the potential to impact innovation? Why or why not? Would the proposed disclosures in Part III, Item 6 of proposed Form ATS-N require broker-dealer operators of NMS Stock ATSs to reveal too much (or not enough) about their structure and operations? Why or why not? Please support your arguments.
217. Do you believe the proposed disclosures in Part III, Item 6 of proposed Form ATS-N related to the use of SORs (or similar functionality) and algorithms should be applied to affiliates of the broker-dealer operator? Why or why not? Please support your arguments.

218. Do you believe there is other information that market participants might find relevant or useful regarding broker-dealer operators or their affiliates' SORs (or similar functionalities) and algorithms? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
219. Do you believe there is any information regarding broker-dealer operators or their affiliates' SORs (or similar functionality) and algorithms that the NMS Stock ATS should not be required to disclose on proposed Form ATS-N due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
220. Do you believe that most subscribers to ATSs that transact in NMS stock access the ATSs through the SOR (or similar functionality) or algorithm of the broker-dealer operator (or its affiliates), or do they connect directly to the ATS through some other means, or both? Please explain in detail.
221. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part III, Item 6 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part III, Item 6?

#### **8. Shared Employees of NMS Stock ATS**

Part III, Item 7 of proposed Form ATS-N would require an NMS Stock ATS to state whether any employee of the broker-dealer operator that services the operations of the NMS Stock ATS also services any other business unit(s) of the broker-dealer operator or any

affiliate(s) of the broker-dealer operator (“shared employee”) and, if so, to (1) identify the business unit(s) and/or the affiliate(s) of the broker-dealer operator to which the shared employee(s) provides services and identify the position(s) or title(s) that the shared employee(s) holds in the business unit(s) and/or affiliate(s) of the broker-dealer operator; and (2) describe the roles and responsibilities of the shared employee(s) at the NMS Stock ATS and the business unit(s) and/or affiliate(s) of the broker-dealer operator.<sup>414</sup>

Part III, Item 7 of proposed Form ATS-N is designed to provide information to market participants and the Commission about circumstances that might give rise to a potential conflict of interest and potential information leakage involving shared employees of the broker-dealer operator. Responses to Part III, Item 7 of proposed Form ATS-N would require an NMS Stock ATS to describe the roles and responsibilities of the shared employees with the NMS Stock ATS and the other business units of the broker-dealer operator or affiliates. Responses to Part III, Item 7 of proposed Form ATS-N would be required to be sufficiently detailed to provide a comprehensive understanding of the full range of the shared employee’s responsibilities with the NMS Stock ATS and each relevant entity, and include disclosure of responsibilities that could enable the employee to view subscribers’ confidential trading information. The Commission preliminarily believes that market participants would find information about the multiple roles or functions of shared employees disclosed in Part III, Item 7 of proposed Form ATS-N important in evaluating whether to route orders to a particular ATS. For example, to identify and understand potential sources of information leakage, market participants would likely want to know if an employee of the broker-dealer operator that is responsible for the operations of a

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<sup>414</sup> See Part III, Item 7 of proposed Form ATS-N.

system supporting the NMS Stock ATS is also responsible for the proprietary trading activity of an affiliate of the broker-dealer operator that trades on the NMS Stock ATS. In this example, market participants might also be interested in understanding conflicts of interest that may result from the shared employee performing multiple roles, as the shared employee could have an incentive to alter the operations of the NMS Stock ATS to benefit the broker-dealer operator or an affiliate of the NMS Stock ATS.<sup>415</sup>

The Commission would preliminarily view any personnel that service the trading functions of the NMS Stock ATS, such as those performing information technology, programming, testing, or system design functions as employees that “service the operations of the NMS Stock ATS.” Other employees of the NMS Stock ATS that are otherwise necessary for the trading functions of the NMS Stock ATS would also be included in the disclosure requirement of Part III, Item 7 of proposed Form ATS-N. Clerical employees or those performing solely administrative duties such as the payroll functions for the employees of the NMS Stock ATS would preliminarily not be included within the proposed disclosure.

Request for Comment

222. Do you believe the Commission should require the disclosure of the information on Part III, Item 7 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.

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<sup>415</sup> The Commission notes that a broker-dealer operator may have valid business reasons for it or its affiliates having shared employees, and the Commission is not proposing to limit the ability for a broker-dealer operator to have such arrangements.

223. Do you believe Part III, Item 7 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to “shared employees”? Why or why not? Please support your arguments.
224. Do you believe that Part III, Item 7 of proposed Form ATS-N is sufficiently clear with respect to the disclosures that would be required relating to shared employees of the broker-dealer operator? If not, how should Part III, Item 7 of proposed Form ATS-N be revised to provide additional clarity? Please explain.
225. Do you believe that it is sufficiently clear who would be considered a “shared employee” under Part III, Item 7 of proposed Form ATS-N? Why or why not? Is the scope of “shared employees” provided under Part III, Item 7 reasonable? Why or why not? Please explain.
226. Do you believe there is any information contained in the proposed disclosures in Part III, Item 7 of proposed Form ATS-N regarding shared employees of the broker-dealer operator that the NMS Stock ATS should not be required to disclose on proposed Form ATS-N due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
227. What are the potential costs and benefits of disclosing the information required by Part III, Item 7 of proposed Form ATS-N? Do you believe the disclosures in Part III, Item 7 of proposed Form ATS-N would have the potential to impact innovation or the manner in which NMS Stock ATSs and broker-dealer operators use their employees? Why or why not? Would the proposed disclosures in Part III, Item 7 of proposed Form ATS-N require broker-dealer operators of NMS

Stock ATSs to reveal too much (or not enough) information about their structure and operations? Why or why not? Please support your arguments.

228. Do you believe there is other information that market participants might find relevant or useful regarding shared employees of the broker-dealer operator? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
229. Do you believe that the Commission should expand the proposed disclosures in Part III, Item 7 of proposed Form ATS-N to other employees, personnel, or independent contractors of the broker-dealer operator? Why or why not? If so, which employees, personnel, or independent contractors should be included and what information about such persons should be solicited? Please explain.
230. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part III, Item 7 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part III, Item 7?

#### **9. Service Providers to the NMS Stock ATS**

Part III, Item 8 of proposed Form ATS-N would require an NMS Stock ATS to disclose whether any operation, service, or function of the NMS Stock ATS is performed by any person(s) other than the broker-dealer operator of the NMS Stock ATS, and if so to: (1) identify the person(s) (in the case of a natural person, to identify only the position or title) performing the operation, service, or function and note whether this service provider(s) is an affiliate of the

broker-dealer, if applicable; (2) describe the operation, service, or function that the identified person(s) provides and describe the role and responsibilities of that person(s); and (3) state whether the identified person(s), or any of its affiliates, may enter orders or other trading interest on the NMS Stock ATS and, if so, describe the circumstances and means by which such orders or other trading interest are entered on the NMS Stock ATS.<sup>416</sup>

The Commission notes that Part III, Item 8 of proposed Form ATS-N expands on the disclosure requirements of Exhibit E on current Form ATS, which requires ATSs to disclose the name of any entity other than the ATS that will be involved in the operation of the ATS, including the execution, trading, clearing and settling of transactions on behalf of the ATS; and to provide a description of the role and responsibilities of each entity.<sup>417</sup> Part III, Item 8 of proposed Form ATS-N would require more detailed information about service providers to the NMS Stock ATS than is currently required by Form ATS, including whether affiliates of service providers may trade on the NMS Stock ATS.<sup>418</sup>

Under Part III, Item 8(a) of proposed Form ATS-N, the NMS Stock-ATS must identify any entity that performs any operation, service, or function for the NMS Stock ATS.<sup>419</sup> For

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<sup>416</sup> See Part III, Item 8 of proposed Form ATS-N.

<sup>417</sup> See Item 7 of Form ATS (describing the requirements for Exhibit E to Form ATS).

<sup>418</sup> The Commission notes that a broker-dealer operator may have valid business reasons for it or its affiliates to have functions of the NMS Stock ATS performed by person(s) other than the broker-dealer operator of the NMS Stock ATS. The Commission is not proposing to limit the ability for a broker-dealer operator to have such arrangements

<sup>419</sup> The Commission is not proposing to require than an NMS Stock ATS provide any personally identifiable information about any natural person in Part III, Item 8(a) of proposed Form ATS-N. Part III, Item 8(a) of proposed Form ATS-N is designed to solicit sufficient information to identify the entity or person providing the service, operation, or function to the NMS Stock ATS, such as the position or title in the case of a natural person acting as a service provider.

example, an NMS Stock ATS may engage a third-party service provider to provide market data for the NMS Stock ATS to, among other things, calculate reference prices (such as the NBBO). Responses to Part III, Item 8(a) of proposed Form ATS-N would be required to include the name of the company that provides the market data, as further described below. Part III, Item 8(b) of proposed Form ATS-N would require an NMS Stock ATS to provide, in detail, information about the operations, service, or function of the NMS Stock ATS that is provided by the identified third-party in Part III, Item 8(a) of proposed Form ATS-N and its roles and responsibilities with respect to that operation, service, or function. For example, a broker-dealer operator may engage a third party to host and maintain the trading platform of the NMS Stock ATS. Part III, Item 8(b) of proposed Form ATS-N would require a description of those services and the specific role and responsibilities of the company and its employees. Responses to Part III, Item 8(b) of proposed Form ATS-N would be required to be sufficiently detailed such that market participants and the Commission could understand what functions are performed by a person other than an employee of the broker-dealer operator and what those services include. As guidance for completing this proposed disclosure item, the Commission would view an NMS Stock ATS simply stating that a third-party provides technology or hardware services to the NMS Stock ATS as not sufficiently responsive to the required disclosure. Responses to Part III, Item 8(b) of proposed Form ATS-N, in the example above, would require a detailed description of information technology services, including both hardware and software that may be provided, as well as any programming, ongoing maintenance, monitoring, and other functions the service provider would perform with respect to the NMS Stock ATS. As additional guidance, responses to Item 8 would also be required to include any service provider that provides, for example, such functions as consulting relating to the trading systems or functionality, cyber security, regulatory

compliance, and record keeping services or functions of the NMS Stock ATS. Additionally, an NMS Stock ATS would be required to identify and describe the services of any service provider engaged for the purposes of the clearance and settlement of trades for the NMS Stock ATS.<sup>420</sup>

The Commission intends that the proposed disclosure requirements of Items 8(a) and (b) of Part III of proposed Form ATS-N would apply to any operation, service, or function performed by any person outside of the NMS Stock ATS entity, including affiliates of the broker-dealer operator.<sup>421</sup> However, services provided to the NMS Stock ATS by employees of the broker-dealer operator would not need to be disclosed in Part III, Item 8 of proposed Form ATS-N. The activities of such persons, to the extent they are shared employees, would be disclosed pursuant to Part III, Item 7 of proposed Form ATS-N.<sup>422</sup> The Commission also notes that it does not intend that the proposed disclosure requirements of Part III, Item 8 of proposed Form ATS-N would extend to operations, services, or functions that are administrative in nature and do not pose a significant risk of information leakage of confidential trading information, such as payroll functions servicing employees of the NMS Stock ATS or e-mail services provided by an outside provider, because the Commission preliminarily believes that information

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<sup>420</sup> The Commission notes that the examples listed above are not intended to be an exhaustive list of the types of services, and the level of detail about those services, that would be required by Part III, Item 8 of proposed Form ATS-N. The Commission preliminarily believes that the appropriate disclosure would be driven by the particular facts and circumstances of operational structure of the NMS Stock ATS.

<sup>421</sup> If, for example, the SOR of an affiliate of the broker-dealer operator is used to route orders to and from the NMS Stock ATS, the SOR would need to be disclosed in Part III, Item 8 of proposed Form ATS-N and would likely also need to be disclosed in Part III, Item 6 of proposed Form ATS-N, which relates to SORs used by the broker-dealer operator or its affiliates.

<sup>422</sup> See supra Section VII.B.8 (discussing proposed requirements for disclosure pertaining to NMS Stock ATS employees that are shared employees with other business units of the broker-dealer operator or its affiliates).

about the services of such third-party services providers and their employees would not be relevant to market participants' evaluation of an NMS Stock ATS as a trading venue and would not be necessary for the Commission's oversight functions.

Items 8(a) and (b) of Part III of proposed Form ATS-N are designed to provide market participants and the Commission with information about how the NMS Stock ATS operates, potential conflicts of interest, and the potential for information leakage. In particular, the Commission preliminarily believes that this information would inform market participants, as well as the Commission, about what aspects of the NMS Stock ATS's operations are performed by third-parties that may or may not be under the control of the broker-dealer operator. For example, an NMS Stock ATS whose trading system is operated or supported by a third-party service provider may have business interests that are aligned with those of the service provider. Additionally, depending on the role and responsibilities of the third-party service provider, market participants may want to evaluate the robustness of the NMS Stock ATS's safeguards and procedures to protect confidential subscriber information.

Lastly, Part III, Item 8(c) of proposed Form ATS-N would require an NMS Stock ATS to state whether any person identified in Part III, Item 8(a) of proposed Form ATS-N or any of its affiliates may enter orders or other trading interest on the NMS Stock ATS and if so, to describe the circumstances and means by which such orders or other trading interests are entered on the NMS Stock ATS. The purpose of these disclosures is to provide market participants and the Commission with information about the potential for conflicts of interest that may result from a service provider, or its affiliates, trading on the NMS Stock ATS and the potential for information leakage. For example, the Commission preliminarily believes that a subscriber or potential subscriber likely would want to know whether a person that is not an employee of the

broker-dealer operator, but is contracted to service the trading platform that contains the NMS Stock ATS's book of orders, could enter orders or other trading interest on the NMS Stock ATS. Similarly, the Commission preliminarily believes that a subscriber or a potential subscriber would also want to know whether an affiliate of the service provider could enter orders or other trading interest on the NMS Stock ATS as well and whether its means of access differ from other subscribers. Under both of these scenarios, a potential conflict of interest could result if the service provider has business interests that compete with the trading interests of other subscribers to the NMS Stock ATS.

Request for Comment

231. Do you believe the Commission should require the disclosure of the information on Part III, Item 8 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
232. Do you believe Part III, Item 8 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS regarding any operation, service, or function of the NMS Stock ATS performed by any person other than the broker-dealer operator? Why or why not? Please support your arguments.
233. Do you believe that Part III, Item 8 of proposed Form ATS-N is sufficiently clear with respect to the disclosures that would be required relating to service providers of the NMS Stock ATS? If not, how should Part III, Item 8 of proposed Form ATS-N be revised to provide additional clarity? Please explain.

234. What are the potential costs and benefits of disclosing the information required by Part III, Item 8 of proposed Form ATS-N? Do you believe the disclosures in Part III, Item 8 of proposed Form ATS-N would have the potential to impact innovation or discourage arrangements with other service providers? Why or why not? Would the proposed disclosures in Part III, Item 8 of proposed Form ATS-N require broker-dealer operators of NMS Stock ATSs to reveal too much (or not enough) information about their structure and operations? Why or why not? Please support your arguments.
235. Do you believe that any of the information in the proposed disclosure requirements of Part III, Item 8 of proposed Form ATS-N regarding service providers to the NMS Stock ATS should not be required to be disclosed on proposed Form ATS-N due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
236. Do you believe the Commission should adopt a more limited or expansive definition of "affiliate" for purposes of this disclosure item? Why or why not? Please support your arguments.
237. Do you believe there is other information that market participants might find relevant or useful regarding any operation, service, or function of the NMS Stock ATS performed by any person other than the broker-dealer operator? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.

238. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part III, Item 8 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part III, Item 8?

#### **10. Differences in Availability of Services, Functionality, or Procedures**

Part III, Item 9 of proposed Form ATS-N would require an NMS Stock ATS to identify and describe any service, functionality, or procedure of the NMS Stock ATS that is available or applies to the broker-dealer operator or its affiliates, that is not available or does not apply to a subscriber(s) to the NMS Stock ATS. The purpose of this disclosure is to alert market participants to the existence of system, functionality, or trading features that the broker-dealer operator or its affiliates may have that other subscribers do not.<sup>423</sup> For example, an NMS Stock ATS may employ different procedures governing how orders entered on the NMS Stock ATS by the broker-dealer operator's business units or affiliates are segmented than it does for other subscribers. The Commission preliminarily believes that the disclosure of those differences in procedures would allow market participants to evaluate whether such differences might put them at a disadvantage when competing against the broker-dealer operator or its affiliates for an execution on the NMS Stock ATS and thus, better enable market participants to decide whether submitting order flow to that NMS Stock ATS aligns with their trading or investment objectives.

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<sup>423</sup> The Commission notes that it is similarly proposing to require NMS Stock ATSs to disclose differences in the treatment of subscribers on the NMS Stock ATS in a number of proposed disclosure requirements. See, e.g., proposed Items 1(a) and 1(b) of Part IV of proposed Form ATS-N.

The Commission notes that a significant difference between national securities exchanges and NMS Stock ATSs is the extent to which each trading center allows access to its services by its users. Section 6(b)(2) of the Exchange Act generally requires registered national securities exchanges to allow any qualified and registered broker-dealer to become a member of the exchange—a key element in assuring fair access to national securities exchange services.<sup>424</sup> In contrast, the access requirements that apply to ATSs are much more limited. Because NMS Stock ATSs are exempt from the definition of an “exchange” so long as they comply with Regulation ATS, and thus, are not required to register as a national securities exchange pursuant to Sections 5 and 6 of the Exchange Act, NMS Stock ATSs are not required to provide fair access unless they reach a 5% trading volume threshold in a stock, which almost all NMS Stock ATSs currently do not.<sup>425</sup> As a result, access to the services of NMS Stock ATSs is determined primarily by private negotiation, and such access to services can differ among persons that subscribe to the NMS Stock ATS.

While the Commission is not proposing to change the fair access requirements applicable to NMS Stock ATSs in this proposal, the Commission is proposing to require, among other things, disclosures on Form ATS-N that identify and describe differences among subscribers (or other persons) in the services, procedures or functionalities that an NMS Stock ATS provides, as well as disclosures that identify and describe any services, functionalities, or procedures of an NMS Stock ATS that are available to the broker-dealer operator’s affiliates, but are not available to subscribers. The Commission preliminarily believes that the disclosure of these differences

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<sup>424</sup> 15 U.S.C. 78f(b)(2).

<sup>425</sup> See 17 CFR 242.301(b)(5). See also *supra* notes 92-95 and accompanying text (discussing the fair access requirements of Regulation ATS).

would allow market participants to evaluate whether such differences might put them at a disadvantage when trading on a particular NMS Stock ATS and thus, better enable market participants to decide whether submitting order flow to that NMS Stock ATS aligns with their trading or investment objectives.

The Commission notes that ATSs may treat subscribers differently with respect to the services offered by the ATS unless prohibited by applicable federal securities laws or the rules and regulations thereunder. For example, an ATS with at least 5% of the average daily volume for any covered security during four of the preceding six months is required to comply with fair access requirements under Rule 301(b)(5) of Regulation ATS,<sup>426</sup> which, among other things, requires an ATS to establish written standards for granting access to trading on its system and not unreasonably prohibiting or limiting any person with respect to access to services offered by the ATS by applying the written standards in an unfair or discriminatory manner. Thus, for example, an ATS that discloses a service to one class of subscribers (or makes the associated functionality available to only one class of subscribers) could not, if it were subject to the fair access requirements, discriminate in this manner unless it had fair and non-discriminatory reasons for doing so. The Commission further notes that, even if an ATS is not subject to the fair access requirements, inaccurate or misleading disclosures about an ATS's operations could result in violations of the antifraud provisions of the federal securities laws.<sup>427</sup>

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<sup>426</sup> See *id.*

<sup>427</sup> See, e.g., UBS Settlement at 14, ITG Settlement at 15, Pipeline Settlement at 16, and Liquidnet Settlement at 14, *supra* note 372 (all noting violations of Section 17(a)(2) of the Securities Act, which prohibits, directly or indirectly, in the offer or sale of securities, obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.) 15 U.S.C. 77q(a)(2).

Request for Comment

239. Do you believe the Commission should require the disclosure of the information on Part III, Item 9 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
240. Do you believe Part III, Item 9 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to any service, functionality, or procedure of the NMS Stock ATS that is available or applies to the broker-dealer operator or its affiliates, that is not available or does not apply to a subscriber(s) to the NMS Stock ATS? Why or why not? Please support your arguments.
241. Do you believe there is other information that market participants might find relevant or useful regarding any service, functionality, or procedure of the NMS Stock ATS that is available or applies to the broker-dealer operator or its affiliates, that is not available or does not apply to a subscriber(s) to the NMS Stock ATS? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
242. Do you believe that Part III, Item 9 of proposed Form ATS-N is sufficiently clear with respect to the disclosures that would be required relating to the differences in services provided to the broker-dealer operator or its affiliates trading on the NMS Stock ATS? If not, how should Part III, Item 9 of proposed Form ATS-N be revised to provide additional clarity? Please explain.

243. Do you believe that the proposed disclosures in Part III, Item 9 of proposed Form ATS-N that are intended to cover differences in services, functionalities, or procedures should be applied to affiliates of the broker-dealer operator? Why or why not? Conversely, should such disclosures be extended to more remote affiliates under a revised definition of “affiliate”?<sup>428</sup> Should disclosure apply to a more limited set of affiliates? Why or why not? Please support your arguments.
244. What are the potential costs and benefits of disclosing the information required by Part III, Item 9 of proposed Form ATS-N? Do you believe the disclosures in Part III, Item 9 of proposed Form ATS-N would have the potential to impact innovation? Why or why not? Would the proposed disclosures in Part III, Item 9 of proposed Form ATS-N require broker-dealer operators of NMS Stock ATSs to reveal too much (or not enough) information about their structure and operations? Why or why not? Please support your arguments.
245. Do you believe there is any information regarding differences in services, functionalities, or procedures of the NMS Stock ATS that are available to the broker-dealer operator or its affiliates and not other subscribers that should not be required disclosures on Form ATS-N due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
246. Do you believe that the Commission should propose amendments to Rule 301(b)(5) of Regulation ATS to lower the trading volume threshold in Regulation

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<sup>428</sup>

See, e.g., supra note 383 and accompanying text.

ATS that triggers the fair access requirement from its current 5%? If so, what is the appropriate threshold? Please support your arguments.

247. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part III, Item 9 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part III, Item 9?

#### **11. Confidential Treatment of Trading Information**

Part III, Item 10 of proposed Form ATS-N is based on the requirements of Rule 301(b)(10) of Regulation ATS,<sup>429</sup> and would require an NMS Stock ATS to describe the written safeguards and written procedures to protect the confidential trading information of subscribers to the NMS Stock ATS. It would also require an NMS Stock ATS to: (a) describe the means by which a subscriber can consent or withdraw consent to the disclosure of confidential trading information to any persons (including the broker-dealer operator and any of its affiliates); (b) identify the positions or titles of any persons that have access to the confidential trading information, describe the confidential trading information to which the persons have access, and describe the circumstances under which the persons can access confidential trading information;

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<sup>429</sup> 17 CFR 242.301(b)(10).

(c) describe the written standards controlling employees of the NMS Stock ATS trading for the employees' accounts; and (d) describe the written oversight procedures to ensure that the safeguards and procedures described above are implemented and followed.

As previously noted,<sup>430</sup> the Commission stated when adopting Regulation ATS that Rule 301(b)(10) did not preclude a broker-dealer that operated an ATS from engaging in other broker-dealer functions. However, to prevent the misuse of private subscriber and customer trading information for the benefit of other customers or activities of the broker-dealer operator, the Commission required that ATSS have in place safeguards and procedures to protect that confidential trading information and to separate ATS functions from other broker-dealer functions.<sup>431</sup> In adopting Rule 301(b)(10), the Commission stated that the rule was meant to ensure that information, such as the identity of subscribers and their orders, be available only to those employees of the alternative trading system who operate the system or are responsible for its compliance with applicable rules.<sup>432</sup> Thus, a broker-dealer operator may not convert confidential trading information of ATS subscribers for use by the non-ATS business units operated by the broker-dealer.

The protection of subscribers' confidential trading information remains a bedrock component of the regulation of ATSS, including those that trade NMS stocks, and is essential to ensuring the integrity of ATSS as execution venues. To the extent that subscribers cannot be assured that their confidential trading information will be protected by an ATS, many of the

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<sup>430</sup> See infra Section IX and X (discussing the requirements of Rule 301(b)(10) and proposed amendments to require that safeguards and procedures be written and preserved).

<sup>431</sup> See Regulation ATS Adopting Release, supra note 7, at 70879.

<sup>432</sup> Id.

advantages or purposes for which a subscriber may choose to send its orders to an ATS (e.g., trade anonymously and/or to mitigate the impact of trading large positions)<sup>433</sup> are eliminated. Moreover, if subscribers' confidential trading information is shared without subscribers' consent, that information may be used by the recipient of the information to gain a competitive advantage over the subscriber. In cases where the confidential trading information of a subscriber is impermissibly shared with the personnel of the broker-dealer operator or any of its affiliates (i.e., persons who are not responsible for the operation of the ATS or compliance with applicable rules), such an abuse is compounded by the conflicting interests of the broker-dealer operator. That is, in such a case, the broker-dealer operator has invited subscribers to trade on its ATS and may have abused that relationship to provide itself or its affiliates with a direct competitive advantage over that subscriber. The Commission preliminarily believes that disclosure is necessary in this area so market participants can independently evaluate the robustness of the safeguards and procedures that are employed by the NMS Stock ATS to protect subscriber confidential trading information and decide for themselves whether they wish to do business with a particular NMS Stock ATS.

Part III, Item 10(a) of proposed Form ATS-N would require the NMS Stock ATS to describe the means by which a subscriber can consent or withdraw consent to the disclosure of confidential trading information to any persons (including the broker-dealer operator and any of its affiliates). Disclosing the means by which a subscriber can consent or withdraw consent from the sharing of such information would allow subscribers and potential subscribers to understand

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<sup>433</sup> See *id.* (stating that many of the ATSs popular at the time Regulation ATS was adopted were anonymous and that many ECNs at that time were popular because they permitted wide dissemination of orders but provided anonymity).

what information about their orders or other trading interest will be kept confidential and how they can specify the means by which they choose to share confidential information. As the Commission noted in the adoption of Regulation ATS, subscribers should be able to give consent if they so choose to share their confidential trading information.<sup>434</sup> ATSs that transact in NMS stocks vary in terms of what types of orders, indications of interests, or other forms of trading interest are confidential on their systems and what specific information about such trading interest may be shared. For example, an ATS might provide that no IOIs submitted by subscribers will be considered confidential, but may provide subscribers with the option to restrict the information in the IOI message to just the symbol and side (*i.e.*, buy or sell). In this example, responses to Item 10(a) would require an NMS Stock ATS to describe the means by which a subscriber or potential subscriber could control some of the information contained in the IOI message by providing consent or withdrawing such consent for the sharing of its confidential trading information.<sup>435</sup>

Part III, Item 10(b) of proposed Form ATS-N, which would require that ATSs identify any person that has access to confidential trading information, the type of information, and the circumstances under which they may access such information, is meant to provide transparency into the potential sources from which confidential trading information might be compromised. As noted above, Regulation ATS requires that access to confidential subscriber information be available only to those employees of the ATS that operate the system or are responsible for the

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<sup>434</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70879.

<sup>435</sup> The Commission notes that there may be some NMS Stock ATSs that might not offer any means by which a subscriber could consent to the dissemination of its confidential trading information. An NMS Stock ATS would be required to disclose this fact pursuant to Item 9(a).

ATS's compliance with applicable rules.<sup>436</sup> The Commission preliminarily believes that requiring ATSs to disclose the list by title or position of all personnel that can access the confidential trading information of subscribers would buttress the existing obligations on ATSs to restrict access only to permitted personnel (*i.e.*, those responsible for its operation or compliance).

Part III, Item 10(b) of proposed Form ATS-N would also require the NMS Stock ATS to describe the confidential trading information that may be accessed by permitted persons. For example, employees that operate the NMS Stock ATS may be able to see the size, side, and symbol of an order but not the identity of the subscriber that submitted the order. The Commission preliminarily believes that subscribers and potential subscribers to the NMS Stock ATS likely would find it useful to know the range of confidential trading information that a person may have access to. Item 10(b) would also require the disclosure of the circumstances under which confidential trading information may be accessed by permitted persons. This disclosure requirement is designed to encompass the reasons for which confidential subscriber information might be accessed. For example, an NMS Stock ATS may only permit its designated employees access to confidential subscriber information when it is necessary to break certain trades or to perform system maintenance or repairs. Disclosures in Item 10(b) generally should describe whether the information is available in real-time (*i.e.*, as trading is occurring on

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<sup>436</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70879; 17 CFR 242.301(b)(10)(i)(A).

the platform) or whether the information relates to historical activity by one or more subscribers.<sup>437</sup>

Part III, Items 10(c) and (d) of proposed Form ATS-N closely track the existing requirements of Regulation ATS encompassed in Rule 301(b)(10)(i)(B) and (b)(10)(ii) respectively. The Commission preliminarily believes that market participants and the Commission would benefit from a description of the NMS Stock ATS's standards in ensuring that employees of the NMS Stock ATS cannot trade for their own account using confidential trading information and the procedures adopted by the NMS Stock ATS to ensure its safeguards and procedures are followed. The Commission notes that, pursuant to existing Rule 301(b)(10), the Commission requires ATSs to have in place such standards, policies, and procedures. As discussed in greater detail below, the Commission is proposing to amend Regulation ATS to provide that these standards, policies, and procedures be written.<sup>438</sup> By requiring that these standards, policies, and procedures be written and that a description of them be publicly disclosed in Part III, Item 10 of proposed Form ATS-N, NMS Stock ATSs may be encouraged to carefully consider the adequacy of their means of protecting the confidential trading information of subscribers, which may result in more robust protections of such information. Market participants would be able to evaluate the relative robustness of such standards, policies, and procedures based on the disclosures provided in Part III, Item 10 of proposed Form ATS-N,

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<sup>437</sup> For example, an NMS Stock ATS that permits access to the confidential trading information of subscribers for breaking trades generally should specify, if true, that access to that information would only be of previous activity on the NMS Stock ATS for the purpose of breaking a trade.

<sup>438</sup> See infra Section IX.

which would in turn allow them to better evaluate the NMS Stock ATS to which they might route orders or become a subscriber.

Request for Comment

248. Do you believe the Commission should require the disclosure of the information on Part III, Item 10 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
249. Do you believe Part III, Item 10 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to the written safeguards and written procedures to protect the confidential trading information of subscribers to the NMS Stock ATS? Why or why not? Please support your arguments.
250. Do you believe that Part III, Item 10 of proposed Form ATS-N is sufficiently clear with respect to the disclosures that would be required relating to the NMS Stock ATS's obligations under Rule 301(b)(10) of Regulation ATS, including a description of the safeguards and procedures of the NMS Stock ATS to protect the confidential trading information of subscribers? If not, how should Part III, Item 10 of proposed Form ATS-N be revised to provide additional clarity? Please explain.
251. Do you believe that any of information in the proposed disclosure requirements of Part III, Item 10 of proposed Form ATS-N, including a description of the NMS Stock ATS's safeguards and procedures to protect the confidential trading information of subscribers, should not be required to be disclosed on proposed Form ATS-N due to concerns regarding confidentiality, business reasons, trade

secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.

252. Do you believe that the proposed disclosures in Part III, Item 10(a) of proposed Form ATS-N requiring an NMS Stock ATS to describe the means by which a subscriber can consent or withdraw consent to the disclosure of confidential trading information should be disclosed? Do ATSs that currently transact in NMS stock inform subscribers as to what trading information is considered confidential and/or provide a means for subscribers to give or withdraw consent to the disclosure of such trading information? Please explain.
253. Do you believe that the proposed disclosures in Part III, Item 10(b) of proposed Form ATS-N requiring an NMS Stock ATS to identify the positions or titles of any persons that have access to the confidential trading information of subscribers, what information they may obtain, and the circumstances under which such persons may obtain that information should be disclosed? Why or why not? Please support your arguments.
254. Do you believe there is other information that market participants might find relevant or useful regarding NMS Stock ATSs obligations under Rule 301(b)(10) and the protection of the confidential trading information of subscribers that has not been proposed in Part III, Item 10 of proposed Form ATS-N? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.

255. What are the potential costs and benefits of disclosing the information required by Part III, Item 10 of proposed Form ATS-N? Would the proposed disclosures in Part III, Item 10 of proposed Form ATS-N require broker-dealer operators of NMS Stock ATSS to reveal too much (or not enough) information about their structure and operations? Why or why not? Please support your arguments.
256. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSS by Part III, Item 10 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part III, Item 10?

### VIII. Part IV of Proposed Form ATS-N: The Manner of Operations of the NMS Stock ATS

Given the dispersal of trading volume in NMS stocks among an increasing number of trading centers,<sup>439</sup> the decision of where to route orders to obtain best execution for market participants is critically important. Today, NMS Stock ATSS account for a significant source of liquidity for NMS stocks and compete with, and operate functionally similar to, registered national securities exchanges.<sup>440</sup> Notwithstanding the importance of NMS Stock ATSS as a source of liquidity in NMS stocks and the increasing operational complexity of NMS Stock ATSS, market participants have limited information about how these markets operate. The Commission is concerned that this lack of operational transparency impedes market participants from adequately discerning how orders interact, match, and execute on NMS Stock ATSS, and may hinder market participants' ability to obtain, or monitor for, best execution for their orders. The current disclosures on Form ATS are confidential, and even in cases where an ATS voluntarily discloses its Form ATS publicly, ATSS have often been reluctant to provide more than summary disclosures about their operations. As a result, neither the Commission nor market participants currently receive a full picture of the operations of NMS Stock ATSS. The Commission preliminarily believes that the information that would be disclosed on proposed Form ATS-N, and in particular Part IV of the Form, would significantly improve the opportunity for market participants and the Commission to understand the operations of NMS Stock ATSS.

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<sup>439</sup> See supra Section III.A (discussing the various trading venues for NMS stocks and the significance of NMS Stock ATSS as a significant source of liquidity).

<sup>440</sup> See id.

Part IV of proposed Form ATS-N would require that the NMS Stock ATS include as Exhibit 4 information about the operations of an NMS Stock ATS. Specifically, Part IV of proposed Form ATS-N would require detailed information about the operations of NMS Stock ATSs, including the following, which are discussed in more detail below: subscribers; hours of operations; order types; connectivity and order entry; segmentation of order flow; display of orders and trading interest; trading services; procedures governing suspension of trading and trading during system disruptions and malfunctions; opening, reopening, closing and after-hours trading procedures; outbound routing from the NMS Stock ATS; use of market data by the NMS Stock ATS; fees; trade reporting, clearance and settlement procedures; order display and execution access; and fair access standards. The proposed disclosure requirements are designed to assist market participants in assessing an NMS Stock ATS as a trading venue. The Commission preliminarily believes that the information that would be required to be disclosed on proposed Form ATS-N would allow market participants to compare and evaluate NMS Stock ATSs, as well as compare NMS Stock ATSs with national securities exchanges, as the type and level of information required by Part IV of proposed Form ATS-N would be generally similar to the information disclosed by national securities exchanges about their operations. For example, the rules of national securities exchanges, which are publicly available,<sup>441</sup> include membership eligibility requirements, hours of operations, the operation of order types, the structure of the market (e.g., auction market, limit order matching book), priority, and opening and closing procedures, among other things. In addition, information provided on proposed Form ATS-N

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<sup>441</sup> See supra note 302.

should assist the Commission, and the SRO for the broker-dealer operator, in exercising oversight over the broker-dealer operator.<sup>442</sup>

#### A. Subscribers

Part IV, Item 1 of proposed Form ATS-N would require an NMS Stock ATS to disclose information regarding any eligibility requirements to access the NMS Stock ATS, terms and conditions of use, types of subscribers, arrangements with liquidity providers, and any procedures or standards to limit or deny access to the NMS Stock ATS.<sup>443</sup>

Part IV, Item 1(a) of proposed Form ATS-N would require an NMS Stock ATS to describe any eligibility requirements to gain access to the services of the NMS Stock ATS. If the eligibility requirements are not the same for all subscribers and persons, an NMS Stock ATS would be required to describe any differences. This item is designed to provide potential subscribers with information about any conditions they would need to satisfy prior to accessing the NMS Stock ATS. Based on Commission experience, the eligibility process and requirements to access an NMS Stock ATS vary, and the requirements may differ depending on whether a potential subscriber is a customer of the broker-dealer operator of the NMS Stock ATS. For instance, some NMS Stock ATSs require that a potential subscriber be a broker-dealer to enter

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<sup>442</sup> The SRO for an ATS has responsibility for overseeing the activities of the broker-dealer operator, which includes the activities of the NMS Stock ATS and surveilling the trading that occurs on the NMS Stock ATS. See Regulation ATS Adopting Release, supra note 7, at 70863.

<sup>443</sup> The Commission notes that Exhibit A of current Form ATS requires an ATS to describe its classes of subscribers (for example, broker-dealer, institution, or retail) and any differences in access to the services offered by the ATS to different groups or classes of subscribers. Part IV, Section 1 of proposed Form ATS-N would require similar information, but the proposed requirements of Form ATS-N are designed to solicit more detailed information than that currently solicited by Form ATS.

orders on the NMS Stock ATS, while other NMS Stock ATSs do not. Some NMS Stock ATSs may require potential subscribers to submit financial information as a pre-requisite to subscribing to, or maintaining their subscriber status on, the NMS Stock ATS.<sup>444</sup> The Commission preliminarily believes that market participants would find it useful to understand an NMS Stock ATS's eligibility requirements so they may determine whether they may qualify for access to an NMS Stock ATS.<sup>445</sup> The Commission preliminarily believes that making such information publicly available would provide efficiencies, as a market participant could source information about, and compare and contrast, the eligibility processes and requirements to access different NMS Stock ATSs. The Commission also preliminarily believes that it would be better able to monitor the extent to which NMS Stock ATSs are available to market participants and obtain a thorough understanding of NMS Stock ATS's eligibility processes and requirements.

Request for Comment

257. Do you believe the Commission should require the disclosure of the information on Part IV, Item 1(a) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.

258. Do you believe Part IV, Item 1(a) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to eligibility requirements to gain access to the services of the NMS Stock ATS? Why or why not? Please support your arguments.

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<sup>444</sup> See Regulation ATS Adopting Release, supra note 7, at 70859 (stating that the limitation on ATSs governing the conduct of subscribers does not preclude an ATS from requiring financial information from subscribers).

<sup>445</sup> See Liquidnet letter #1, supra note 166 and accompanying text (stating disclosures should include the admission criteria for each ATS).

259. Is it sufficiently clear what information would be required by Part IV, Item 1(a) of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
260. Do you believe there is other information that market participants might find relevant or useful regarding the eligibility process or requirements to gain access to the services of the NMS Stock ATS? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
261. Do you believe there is any information that would be required by Part IV, Item 1(a) of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
262. Do you believe that subscribers and potential subscribers would benefit from knowing the eligibility requirements of the NMS Stock ATS? Why or why not? Please support your arguments.
263. What are the potential costs and benefits of disclosing the information required by Part IV, Item 1(a) of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 1(a) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.
264. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 1(a) of proposed Form ATS-N

other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 1(a)?

Part IV, Item 1(b) of proposed Form ATS-N would require an NMS Stock ATS to describe the terms and conditions of any contractual agreements for granting access to the NMS Stock ATS for the purpose of effecting transactions in securities or for submitting, disseminating, or displaying orders on the NMS Stock ATS, and to state whether these contractual agreements are written. Furthermore, if the terms and conditions of any contractual agreements are not the same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences. Based on Commission experience, these contractual agreements may or may not be in writing, and the terms and conditions therein can vary among subscribers to the NMS Stock ATSs.

The Commission preliminarily believes that it would be important for all subscribers to have access to all relevant information regarding the terms and conditions for accessing the trading services of the NMS Stock ATS, which today may not always be available to all subscribers. This item would allow subscribers to understand their rights and obligations in connection with their use of the NMS Stock ATS, and allow subscribers and potential subscribers to assess whether other market participants may have access arrangements more favorable than their own. This information is designed to help market participants when evaluating which trading centers they could or would like to access, and on which terms they could seek executions on those trading centers. The Commission preliminarily believes that having such information publicly available would provide efficiencies as market participants could more easily source information about the terms and conditions under which they could

trade across NMS Stock ATSs, as well as compare those terms and conditions to those of national securities exchanges. The Commission understands that some NMS Stock ATSs communicate the terms and conditions to access the NMS Stock ATS orally to subscribers, often as part of an onboarding process, and do not provide written contractual agreements. The Commission preliminarily believes that market participants would benefit from knowing whether a written contractual agreement exists that sets forth the terms and conditions for accessing and trading on the NMS Stock ATS. Furthermore, the Commission preliminarily believes that the disclosures that would be required under Item 1(b) would better inform potential subscribers about whether additional inquiry is necessary to fully understand the terms and conditions for trading on the NMS Stock ATS.

Request for Comment

265. Do you believe the Commission should require the disclosure of the information on Part IV, Item 1(b) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
266. Do you believe Part IV, Item 1(b) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to the terms and conditions of any contractual agreements for granting access to the NMS Stock ATS? Why or why not? Please support your arguments.
267. Is it sufficiently clear what information would be required by Part IV, Item 1(b) of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.

268. Do you believe there is other information that market participants might find relevant or useful regarding the terms and conditions of any contractual agreements by which access is granted to the services of the NMS Stock ATS? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
269. Do you believe there is any information that would be required by Part IV, Item 1(b) of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
270. Do you believe that NMS Stock ATSS commonly have written contractual agreements for granting access to the NMS Stock ATS? Why or why not, and what is the basis for such belief? If not, how is access granted? How are the terms and conditions of trading on the NMS Stock ATS communicated to subscribers? Is there commonly an onboarding process for new subscribers? What does such onboarding process entail? Please explain in detail.
271. Do you believe there are agreements between subscribers and an NMS Stock ATS that are not written? If so, what is the basis for your belief, what do those non-written agreements encompass, and how are they communicated to subscribers? Are any materials other than contracts provided to subscribers that set forth terms and conditions for granting access to the NMS Stock ATS? Please explain in detail.

272. What are the potential costs and benefits of disclosing the information required by Part IV, Item 1(b) of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 1(b) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.

273. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 1(b) of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 1(b)?

Part IV, Item 1(c) of proposed Form ATS-N would require an NMS Stock ATS to describe the types of subscribers and other persons that use the services of the NMS Stock ATS (e.g., institutional and retail investors, broker-dealers, proprietary trading firms). The NMS Stock ATS would also be required to state whether it accepts non-broker-dealers as subscribers to the NMS Stock ATS and describe any criteria for distinguishing among types of subscribers, classes of subscribers, or other persons.

This item would provide information about the types of subscribers to the NMS Stock ATS, or other persons that can enter orders onto the NMS Stock ATS, so that market participants and the Commission would be better informed about the type of order flow that may be present on the NMS Stock ATS. Moreover, this item would, in conjunction with the other disclosure requirements of proposed Form ATS-N regarding differences in access to services or functionality of the NMS Stock ATS, inform market participants of any privileges or restrictions that attach to different categories of subscribers so that subscribers could evaluate which

privileges or restrictions might apply to them or the counterparties against which they would be trading.<sup>446</sup> For example, an NMS Stock ATS may only allow certain types of subscribers, including institutional investors, retail investors, broker-dealers, or proprietary trading firms, to enter a certain type of order on the NMS Stock ATS. Additionally, NMS Stock ATSS may assign different priorities to orders based on the types of subscribers that entered the orders on the NMS Stock ATS, such as orders originating from retail brokerage accounts or proprietary traders. Furthermore, the Commission understands that subscribers may wish to preclude or limit the interaction of their orders with the orders of certain other subscribers for several reasons, such as to help reduce information leakage or the possibility of trading with counterparties that they perceive to be undesirable. Accordingly, the Commission preliminarily believes that subscribers would find it useful to know the types of subscribers or other persons transacting on the NMS Stock ATS, and with that knowledge, they would be in a better position to evaluate the order flow on the NMS Stock ATS and determine whether they may wish to send their orders to the NMS Stock ATS for execution.<sup>447</sup> The Commission also preliminarily believes that increased transparency regarding the types of subscribers—and distinctions an NMS Stock ATS makes among subscribers or other persons when trying to access the ATS—would advance the Commission’s objective of protecting investors by giving them better information with which to protect their own interests.

#### Request for Comment

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<sup>446</sup> But see supra notes 92-95 and 425-427 and accompanying text (discussing the fair access requirements of Regulation ATS).

<sup>447</sup> See Lime Brokerage letter, supra note 192 and accompanying text (stating the Commission should require “transparency around . . . membership of dark pools”).

274. Do you believe the Commission should require the disclosure of the information on Part IV, Item 1(c) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
275. Do you believe Part IV, Item 1(c) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to the types of subscribers and other persons that use the services of the NMS Stock ATS? Why or why not? Please support your arguments.
276. Is it sufficiently clear what information would be required by Part IV, Item 1(c) of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
277. Do you believe there is other information that market participants might find relevant or useful regarding distinctions made by the NMS Stock ATS among subscribers? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
278. Do you believe there is any information that would be required by Part IV, Item 1(c) of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
279. Do you believe that the information that would be required by Part IV, Item 1(c) of proposed Form ATS-N would aid subscribers in evaluating the order flow on

the NMS Stock ATS and determining whether they wish to send their orders there for execution? Why or why not? Please support your arguments.

280. What are the potential costs and benefits of disclosing the information required by Part IV, Item 1(c) of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 1(c) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.

281. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 1(c) of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 1(c)?

Part IV, Item 1(d) of proposed Form ATS-N would require an NMS Stock ATS to describe any formal or informal arrangement the NMS Stock ATS has with a subscriber(s) or person(s) to provide liquidity to the NMS Stock ATS (e.g., undertaking to buy or sell continuously, or to meet specified thresholds of trading or quoting activity). Item 1(d) would further require an NMS Stock ATS to describe the terms and conditions of each arrangement and identify any liquidity providers that are affiliates of the broker-dealer operator.

An NMS Stock ATS may want to ensure that there is sufficient liquidity in a particular NMS stock to incentivize subscribers to send order flow in that NMS stock to the NMS Stock ATS; market participants may believe they are more likely to get an execution because of such liquidity. The Commission understands that some ATSs that trade NMS stocks may engage certain subscribers to provide liquidity to the NMS Stock ATS and perform similar functions to

that of a market maker on a national securities exchange.<sup>448</sup> These liquidity providers may quote in a particular NMS stock on the NMS Stock ATS during trading hours and may receive a benefit for performing this function, such as discounts on fees, rebates, or the opportunity to execute with a particular type of segmented order flow.<sup>449</sup> The obligations required of liquidity providers and the benefits they are provided vary across NMS Stock ATSS. Accordingly, the Commission proposes to require NMS Stock ATSS to describe the terms of any formal or informal arrangement with a liquidity provider, which could entail such obligations and benefits as well as a description of the process by which a subscriber could become a liquidity provider on the NMS Stock ATS. The Commission preliminarily believes that information about liquidity providers would be useful to subscribers and market participants who, for example, may want their orders to only interact with agency orders (and not with those of a liquidity provider), or, conversely, may themselves want to become a liquidity provider on the NMS Stock ATS.

Part IV, Item 1(d) of proposed Form ATS-N would also require an NMS Stock ATS to identify any liquidity providers that are affiliates of the broker-dealer operator. The Commission preliminarily believes that market participants would find it useful to know whether the broker-

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<sup>448</sup> See, e.g., The NASDAQ Stock Market LLC, Rule 4613, Market Maker Obligations. Market-makers on a national securities exchange typically undertake, among other things, two-sided quote obligations where the market maker holds itself out as willing to buy and sell a particular security or securities for its own account on a continuous basis during trading hours. The obligations required of market makers may vary across national securities exchanges.

<sup>449</sup> Often, market makers on national securities exchanges are provided benefits for providing liquidity to the exchange, such as fee discounts, rebates, or volume incentive programs that may not be available to non-market makers. See, e.g., The NASDAQ Stock Market LLC, Rule 7014, Market Quality Incentive Programs (describing the “Qualified Market Maker Program” and “Lead Market Maker Program”). The attendant benefits provided to market makers may vary across national securities exchanges.

dealer operator itself, or its affiliates, have an arrangement to provide liquidity to the NMS Stock ATS. The Commission preliminarily believes that such information could reveal potential conflicts of interest, if, for example, an NMS Stock ATS were to only permit affiliates to act as liquidity providers and provided significant benefits for performing that function.

Request for Comment

282. Do you believe the Commission should require the disclosure of the information on Part IV, Item 1(d) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
283. Do you believe Part IV, Item 1(d) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to any formal or informal arrangement the NMS Stock ATS has with a subscriber(s) or person(s) to provide liquidity to the NMS Stock ATS? Why or why not? Please support your arguments.
284. Is it sufficiently clear what information would be required by Part IV, Item 1(d) of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
285. Do you believe there is other information that market participants might find relevant or useful regarding arrangements with subscribers or other persons to provide liquidity to the NMS Stock ATS? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
286. Do you believe there is any information that would be required by Part IV, Item 1(d) of proposed Form ATS-N that an NMS Stock ATS should not be required to

disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.

287. Do you believe that the information that would be required by Part IV, Item 1(d) of proposed Form ATS-N would aid subscribers in evaluating the order flow on the NMS Stock ATS and determining whether they wish to send their orders there for execution? Why or why not? Please support your arguments.
288. Do you believe that the proposed requirement in Part IV, Item 1(d) of proposed Form ATS-N that the NMS Stock ATS identify any liquidity providers that are affiliates of the broker-dealer operator would aid subscribers in evaluating potential conflicts of interest of the broker-dealer operator, the order flow on the NMS Stock ATS, and determining whether they wish to send their orders there for execution? Why or why not? Please support your arguments.
289. What are the potential costs and benefits of disclosing the information required by Part IV, Item 1(d) of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 1(d) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.
290. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 1(d) of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 1(d)?

Part IV, Item 1(e) of proposed Form ATS-N would require an NMS Stock ATS to describe the circumstances by which access to the NMS Stock ATS for a subscriber or other person may be limited or denied, and describe any procedures or standards that are used to determine such action. If these circumstances, procedures, or standards are not applicable to all subscribers and persons, the NMS Stock ATS would be required to describe any differences. As an ATS, an NMS Stock ATS cannot exercise SRO powers and may not discipline subscribers other than by excluding them from trading.<sup>450</sup> The Commission understands that ATSs that trade NMS stocks have rules governing subscribers' participation on the ATS, and that if a subscriber fails to comply with these rules, the ATS may limit or deny access to the NMS Stock ATS.<sup>451</sup> These limitations can result in some subscribers having different levels of functionality or more favorable terms of access than others. The Commission preliminarily believes that it is important for subscribers to have advance notice of the circumstances under which their access to NMS Stock ATSs would be limited or denied, and the procedures or standards that would be used to govern such actions. The Commission preliminarily believes that understanding such information would provide efficiencies as a market participant could source information about potential limits to accessing an NMS Stock ATS, even if that market participant otherwise meets the eligibility criteria for subscribing to the NMS Stock ATS, and it would allow them to evaluate whether any limitations may result in receiving less favorable access from the NMS

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<sup>450</sup> See supra note 285 and accompanying text.

<sup>451</sup> Form ATS-R, Exhibit C requires an ATS subject to the fair access obligations under Rule 301(b)(5) of Regulation ATS to list all persons granted, denied, or limited access to the ATS during the period covered by the ATS-R report, designating for each person (a) whether they were granted, denied, or limited access; (b) the date the alternative trading system took such action; (c) the effective date of such action; and (d) the nature of any denial or limitation of access. See Form ATS-R.

Stock ATS. The increased transparency regarding these procedures also may advance the Commission's objective of protecting investors by helping the Commission to understand when NMS Stock ATSs deny or limit access to market participants.

Request for Comment

291. Do you believe the Commission should require the disclosure of the information on Part IV, Item 1(e) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
292. Do you believe Part IV, Item 1(e) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to the circumstances by which access to the NMS Stock ATS for a subscriber or other person may be limited or denied? Please explain.
293. Is it sufficiently clear what information would be required by Part IV, Item 1(e) of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
294. Do you believe there is other information that market participants might find relevant or useful regarding the process by which access to an NMS Stock ATS for a subscriber may be limited or denied? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
295. Do you believe there is any information that would be required by Part IV, Item 1(e) of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets,

burden, or any other concerns? If so, what information and why? Please support your arguments.

296. What are the potential costs and benefits of disclosing the information required by Part IV, Item 1(e) of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 1(e) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.
297. Do you believe there are circumstances under which NMS Stock ATSs currently limit the functionality available to subscribers due to an action or inaction on the part of a subscriber? If so, what is the basis for your belief, what are those circumstances, and what functionality is typically limited? Is it common for an NMS Stock ATS to deny access to subscribers as opposed to limiting access? Why or why not, and under what circumstances? Please be specific.
298. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 1(e) of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Items 1(e)?

#### **B. Hours of Operations**

Part IV, Item 2(a) of proposed Form ATS-N would require an NMS Stock ATS to provide the days and hours of operation of the NMS Stock ATS, including the times when orders or other trading interest are entered on the NMS Stock ATS and the time when pre-opening or after-hours trading occur. Also, if the times when orders or other trading interest are entered on

the NMS Stock are not the same for all subscribers and persons, Part IV, Item 2(b) would require the NMS Stock ATS to describe any differences.

The Commission preliminarily believes that it is important for subscribers and the Commission to have information regarding when NMS Stock ATSs are operating and when orders can be entered on those trading centers, including when an NMS Stock ATS will accept orders outside of standard operating hours. The Commission notes that national securities exchanges' rulebooks, which are publicly available, include such information.<sup>452</sup> Making such information publicly available for NMS Stock ATSs would enable market participants to more easily compare when trading interest may be entered on NMS stock trading centers. This information also would allow the Commission to better understand the operations of NMS Stock ATSs.

#### Request for Comment

299. Do you believe the Commission should require the disclosure of the information on Part IV, Item 2 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.

300. Do you believe Part IV, Item 2 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to the days and hours of operation of the NMS Stock ATS? Why or why not? Please support your arguments.

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See, e.g., BATS Exchange Rules 1.5(c) (setting forth hours for the exchange's After Hours Trading Session), 1.5(r) (setting forth hours for the exchange's Pre-Opening Session), 1.5(w) (setting forth the hours for the exchange's Regular Trading Hours), and 11.1 (setting forth the exchange's hours of trading and trading days, and when certain order types may be entered).

301. Do you believe there is other information that market participants might find relevant or useful regarding the hours of operation of an NMS Stock ATS? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
302. Do you believe that Part IV, Item 2 of proposed Form ATS-N is sufficiently clear with respect to the disclosures that would be required? If not, how should Part IV, Item 2 of proposed Form ATS-N be revised to provide additional clarity? Please explain in detail.
303. Do you believe there is any information that would be required by Part IV, Item 2 of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
304. What are the potential costs and benefits of disclosing the information required by Part IV, Item 2 of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 2 of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.
305. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 2 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could

this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 2?

### C. Types of Orders

Part IV, Item 3(a) of proposed Form ATS-N would require an NMS Stock ATS to describe any types of orders that are entered on the NMS Stock ATS, their characteristics, operations, and how they are handled on the NMS Stock ATS, including: (i) priority for each order type; (ii) conditions for each order type; (iii) order types designed not to remove liquidity (e.g., post-only orders); (iv) order types that adjust their price as changes to the order book occur (e.g., price sliding orders or pegged orders) or have a discretionary range; (v) the time-in-force instructions that can be used or not used with each order type; (vi) the availability of order types across all forms of connectivity to the NMS Stock ATS and differences, if any, between the availability of an order type across those forms of connectivity; (vii) whether an order type is eligible for routing to other trading centers; and (viii) the circumstances under which order types may be combined with a time-in-force or another order type, modified, replaced, canceled, rejected, or removed from the NMS Stock ATS.<sup>453</sup> If the availability of order types and their terms and conditions are not the same for all subscribers and persons, Part IV, Item 3(b) would require the NMS Stock ATS to describe any differences. In addition, Part IV, Item 3(c) of Form ATS-N would require an NMS Stock ATS to describe any requirements and handling procedures for minimum order sizes, odd-lot orders, or mixed-lot orders. The NMS Stock ATS must also

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<sup>453</sup> Items 3(a)(i), (ii), (iii), (iv) and (vii) of proposed Form ATS-N provide further requirements of what needs to be included in responding to these items. See discussion under each item infra.

describe any differences if the requirements and handling procedures for minimum order sizes, odd-lot orders, or mixed-lot orders are not the same for all subscribers and persons.<sup>454</sup>

As discussed above, NMS Stock ATSs offer a wide range of order types and modifiers and offer different minimum order size requirements. Order types, in particular, are a primary means by which users of an NMS Stock ATS communicate their instructions for handling their orders to the NMS Stock ATS. Moreover, order types can be complex and operate in various ways, and the Commission is therefore proposing to request that NMS Stock ATSs provide the level of detail set forth in subsections (i) – (viii) of Item 3(a). The Commission believes that all market participants should have sufficient information about all aspects of the operations of order types available on an NMS Stock ATS to understand how to use order types to achieve their investing or trading objectives, as well as to understand how order types used by other market participants could affect their trading interest. Item 3(a) would require a complete and detailed description of the order types available on the NMS Stock ATS, their characteristics, operations, and how they are handled to provide transparency to market participants and the Commission. Subsection (i) of Item 3(a) would require that the NMS Stock ATS describe the priority rules for each order type. The description would be required to include the order type's priority on the NMS Stock ATS upon order entry as well as any subsequent change to priority (if applicable). Also, the NMS Stock ATS would need to describe whether an order type can receive a new time stamp (such as, for example, in the case of order types that adjust price), and such order type's priority vis-à-vis other orders on the book due to changes in the NBBO or other

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<sup>454</sup> The Commission notes that a broker-dealer operator may have valid business reasons for offering various order types to subscribers and the Commission is not proposing to limit the ability for a broker-dealer operator to have such arrangements.

reference price. In addition, this subsection would also require a description of any instance in which the order type could lose execution priority to a later arriving order at the same price.

Subsection (ii) of Item 3(a) would require that the NMS Stock ATS describe any conditions for each order type. Such conditions would include: any price conditions, including how the order type is ranked and how price conditions affect the rank and price at which it can be executed; conditions on the display or non-display of an order; or conditions on the execution or routing of orders.

Subsection (iii) of Item 3(a) would require that the NMS Stock ATS describe order types designed not to remove liquidity (e.g., post-only orders). The NMS Stock ATS would need to describe what occurs when such order is marketable against trading interest on the NMS Stock ATS when received.

Subsection (iv) of Item 3(a) would require that the NMS Stock ATS describe order types that adjust their price as changes to the order book occur (e.g., price-sliding orders or pegged orders) or have a discretionary range. As part of a response, this description would be required to include an order's rank and price upon order entry and whether such prices or rank may change based on the NBBO or other market conditions when using such an order type. In addition, the description would have to include when the order type is executable and at what price the execution would occur, and also whether the price at which the order type can be executed ever changes. Also, if the order type can operate in different ways, the NMS Stock ATS would need to explain the default operation of the order type.

Subsection (v) of Item 3(a) would require the NMS Stock ATS to describe the time-in-force instructions that can be used or not used with each order type.

Subsection (vi) of Item 3(a) would require a description of the availability of order types across all forms of connectivity to the NMS Stock ATS and differences, if any, between the availability of order types across those forms of connectivity. For example, if an NMS Stock ATS offers certain order types to persons who connect through the broker-dealer operator, such as through use of a SOR (or similar functionality) or algorithm, as opposed to persons who connect directly through a FIX connection, that difference in availability would need to be described in response to this subsection.

Subsection (vii) of Item 3(a) would require a description of whether the order type is eligible for routing to other trading centers. The response required by this item would be required to include, if it is routable, whether an order type can be used with any routing services offered.

Subsection (viii) of Item 3(a) would require the NMS Stock ATS to describe the circumstances under which order types submitted to the NMS Stock ATS may be combined with a time-in-force or another order type, modified, replaced, canceled, rejected, or removed from the NMS Stock ATS. If an NMS Stock ATS allows a subscriber to combine separate order types, or combine an order type with a time-in-force restriction, both of those instances would be responsive to subsection (viii) of Item 3(a).

Part IV, Item 3(b) of proposed Form ATS-N would require the NMS Stock ATS to describe any differences if the availability of its orders types and their terms and conditions are not the same for all subscribers and persons.

Part IV, Item 3(c) of proposed Form ATS-N would require an NMS Stock ATS to describe any requirements and handling procedures for minimum order sizes, odd-lot orders, or mixed-lot orders. If the requirements and handling procedures for minimum order sizes, odd-lot

orders, or mixed-lot orders are not the same for all subscribers and persons, the NMS Stock ATS would also be required to describe any differences. These would include, for example, any order size requirements that may differ based on factors such as the type of subscriber or person that uses the services of the NMS Stock ATS, or the type of order (e.g., if only certain subscribers or persons are eligible to use that order type).

The Commission preliminarily believes that a detailed description of the characteristics of the order types of an NMS Stock ATS would assist subscribers in better understanding how their orders would function and interact with other orders on the NMS Stock ATS.<sup>455</sup> It also would allow market participants to see what order types could be used by other market participants, which could affect the probability, timing, and quality of their own executions. Moreover, the Commission preliminarily believes that requiring comprehensive disclosure of an NMS Stock ATS's order types on proposed Form ATS-N would allow market participants to compare order types across NMS Stock ATSs and national securities exchanges. As a result, a market participant would be better able to assess the availability of order types and whether their characteristics would accomplish the market participant's investing or trading objectives.

The Commission also preliminarily believes that the disclosures about the characteristics and functions of order types would allow the Commission to better oversee NMS Stock ATSs, and alert the Commission as to whether the function of a particular order type may violate the federal securities laws or the rules or regulations thereunder, such as the requirement under Rule

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<sup>455</sup> See Consumer Federation of America Letter, supra note 188 and accompanying text (stating the Commission should require all ATSs to disclose certain information about the order types offered on the ATS); Liquidnet letter #1, supra note 171 and accompanying text (stating institutional brokers, including institutional ATSs, should disclose the order types offered).

611 of Regulation NMS that a trading center have policies and procedures reasonably designed to prevent trade-throughs of protected quotations in NMS stocks.<sup>456</sup> The Commission preliminarily believes that the disclosures that would be required by Item 3(a) would help the Commission discover a potential violation of the federal securities laws and rules or regulations thereunder in a more expeditious manner than if the disclosures were not required. The disclosures required by Item 3(a) would also facilitate the Commission's comparison of how the characteristics of order types were described to subscribers and how they operate in practice as part of any examination of the NMS Stock ATS.

The Commission preliminarily believes this information would also advance the Commission's interest in the protection of investors by allowing subscribers to clearly see the types of orders available to them, as well as potential counterparties, and any differences between the order types, available among participants on the NMS Stock ATS.

As noted above, Part IV, Item 3(b) would require the NMS Stock ATS to describe any differences if the availability of its order types and their terms and conditions are not the same for all subscribers and persons. The Commission preliminarily believes that this information would be important for a market participant to better assess whether other participants on the NMS Stock ATS may receive advantageous or disadvantageous treatment as a result of the ATS's various order types and how that treatment may affect that market participant's trading interest. Information about any disparate treatment of investors also would be important for the Commission as it monitors developments in the national market system.

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<sup>456</sup> See 17 CFR 242.611.

Part IV, Item 3(c) of proposed Form ATS-N would require an NMS Stock ATS to describe any requirements and handling procedures for minimum order sizes, odd-lot orders, or mixed-lot orders. The NMS Stock ATS would also be required to explain any differences if the requirements and handling procedures for minimum order sizes, odd-lot orders, or mixed-lot orders are not the same for all subscribers and persons. The information that would be required by Item 3(c) is designed to facilitate the entry of orders by subscribers by providing information on minimum order sizes, odd-lot orders, and mixed-lot orders. An explanation of how an NMS Stock ATS's requirements and conditions for minimum order sizes, odd-lot orders, and mixed-lot orders differ among subscribers and persons would also provide a market participant with information regarding how its trading interest would be handled vis-à-vis other market participants. The information that would be required by Item 3(c) would also be useful to the Commission's monitoring of developments in market structure.

Request for Comment

306. Do you believe the Commission should require the disclosure of the information on Part IV, Items 3(a) – 3(c) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
307. Do you believe Part IV, Items 3(a) – 3(c) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to the types of orders that are entered to the NMS Stock ATS, their characteristics, operations, and how they are handled on the NMS Stock ATS? Please explain.

308. Is it sufficiently clear what information would be required by Part IV, Items 3(a) - 3(c) of proposed Form ATS-N? Should the items be refined in any way? If so, how? Please be specific.
309. Do you believe the proposed requirement to disclose the information that would be required by Part IV, Item 3(a) of proposed Form ATS-N could impact innovation on NMS Stock ATSs? Why or why not? Please support your arguments.
310. Do you believe there is other information that market participants might find relevant or useful regarding the types of orders that are entered to the NMS Stock ATS, their characteristics, operations, and how they are handled on the NMS Stock ATS? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
311. Do you believe there is any information that would be required by Part IV, Items 3(a) - 3(c) of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
312. Do you believe there are any other aspects of order types that an NMS Stock ATS should be required to disclose in a subpart to Part IV, Item 3(a) of proposed Form ATS-N that have not been identified? If so, what? Do you believe there are other order types about which the Commission should ask specifically? If so, what order types? Please explain in detail.

313. Should the Commission require greater specificity regarding the operation of order types? If so, why and how? If not, why not? Please support your arguments.
314. Do you believe that information relating to available order types would help market participants in determining the best trading venue for their orders? Why or why not? Please support your arguments.
315. Do you believe that Items 3(a) - 3(c) of Part IV of proposed Form ATS-N would advance the Commission's interest in the protection of investors by allowing market participants to consider the types of orders available to them, as well as potential counterparties, and any differences between the order types, modifiers, and size requirements available among participants on the NMS Stock ATS? Why or why not? Please support your arguments.
316. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSS by Part IV, Items 3(a) - 3(c) of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Items 3(a) - 3(c)?
317. What are the potential costs and benefits of disclosing the information required by Part IV, Items 3(a) - 3(c) of proposed Form ATS-N? Would the proposed disclosures in Part IV, Items 3(a) - 3(c) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.

318. Do you believe that Part IV, Item 3(a) of proposed Form ATS-N should require a description of priority for each order type? Why or why not? Please support your answer.
319. Do you believe that Part IV, Item 3(a) of proposed Form ATS-N should require a description of any conditions for each order type? Why or why not? Please support your answer.
320. Do you believe that Part IV, Item 3(a) of proposed Form ATS-N should require a description of order types designed not to remove liquidity? Why or why not? Please support your answer.
321. Do you believe that Part IV, Item 3(a) of proposed Form ATS-N should require a description of order types that adjust their price as changes to the order book occur or have a discretionary range? Why or why not? Please support your answer.
322. Do you believe that Part IV, Item 3(a) of proposed Form ATS-N should require a description of the time-in-force instructions for each order type? Why or why not? Please support your answer.
323. Do you believe that Part IV, Item 3(a) of proposed Form ATS-N should require a description of the availability of order types across all forms of connectivity to the NMS Stock ATS? Why or why not? Please support your answer.
324. Do you believe that Part IV, Item 3(a) of proposed Form ATS-N should require a description of whether order types are eligible for routing to other trading centers? Why or why not? Please support your answer.

325. Do you believe that Part IV, Item 3(a) of proposed Form ATS-N should require a description of the circumstances under which order types may be combined with a time-in-force or another order type, modified, replaced, canceled, rejected, or removed from the NMS Stock ATS? Why or why not? Please support your answer.

Part IV, Item 3(d) of proposed Form ATS-N would require an NMS Stock ATS to describe any messages sent to or received by the NMS Stock ATS indicating trading interest (e.g., IOIs, actionable IOIs, or conditional orders), including information contained in the message, the means under which messages are transmitted, the circumstances in which messages are transmitted (e.g., automatically by the NMS Stock ATS or upon the subscriber's request), and the circumstances by which they may result in an execution on the NMS Stock ATS. If the terms and conditions regarding these messages, indications of interest, and conditional orders are not the same for all subscribers and persons, the NMS Stock ATS would be required describe any differences.

This item is designed to provide specific information about the use of IOIs, actionable IOIs, conditional orders, and similar functionalities on the NMS Stock ATS. Based on the Commission's experience, IOIs are used by NMS Stock ATSs to convey trading interest available on those trading centers. Some NMS Stock ATSs also transmit "actionable" IOIs to selected market participants for the purpose of attracting contra-side order flow to the ATS. In general, an actionable IOI is an IOI containing enough information to effectively alert the recipient about the details of the NMS Stock ATS's trading interest in a security. While an actionable IOI may not explicitly specify the price and/or size of the trading interest, the practical context in which it is submitted alerts the recipient about the side (buy or sell), size (minimum of

a round lot of trading interest), and price (at or better than the NBBO, depending on the side of the order).

Conditional orders are also messages indicating a trading interest on a trading venue, and conditional orders generally function in a similar manner to IOIs. A conditional order may contain the same attributes as other order types when a subscriber enters it onto the trading venue (e.g., side, price, and size), but NMS Stock ATSS will generally not transmit those details to other subscribers or market participants. Rather, the NMS Stock ATS will tentatively match the conditional order with contra side interest and then alert the subscriber that entered the conditional order of the potential match. That subscriber may then either accept or decline the execution (i.e., “firm up” the conditional order). Based on Commission experience, NMS Stock ATSS typically only permit conditional orders to execute against other conditional orders, but some ATSS allow conditional orders to interact with other order types.

The Commission preliminarily believes that understanding the manner in which NMS Stock ATSS use IOIs, actionable IOIs, conditional orders, and similar functionalities could be useful to market participants because it could impact the potential execution of a subscriber’s trading interest. Also, because an actionable IOI conveys substantial information, the potential for information leakage could be a concern to NMS Stock ATS subscribers using IOIs, particularly when they are seeking to execute large-sized orders. In the Commission’s experience, NMS Stock ATSS generally send IOIs and other conditional orders only to certain market participants. Accordingly, the disclosures that would be required by Item 3(d) are designed to help market participants better evaluate whether messages indicating trading interest (including IOIs, actionable IOIs, and conditional orders) are equally available to them as

compared to other market participants and would be appropriate tools to accomplish their investing or trading objectives.

Request for Comment

326. Do you believe the Commission should require the disclosure of the information on Part IV, Item 3(d) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
327. Do you believe Part IV, Item 3(d) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to any messages sent to or received by the NMS Stock ATS indicating trading interest? Please explain.
328. Is it sufficiently clear what information would be required by Part IV, Item 3(d) of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
329. Do you believe there is other information that market participants might find relevant or useful regarding messages indicating trading interest (e.g., IOIs, actionable IOIs, or conditional orders)? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
330. Do you believe there are other types of messages that communicate trading interest that the Commission should specifically cite as examples in Part IV, Item 3(d) of proposed Form ATS-N? If so, what are those message types? Please provide a detailed explanation of each additional type of message and support your arguments as to each.

331. Do you believe there is any information that would be required by Part IV, Item 3(d) of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? If so, what information and why? Please support your arguments.
332. Do you believe that there is potential concern for information leakage from the use of IOIs, particularly actionable IOIs on NMS Stock ATSs? If so, would disclosure about their operation on proposed Form ATS-N be an appropriate manner in which to mitigate any concern? If not, why not? Please support your arguments.
333. What are the potential costs and benefits of disclosing the information required by Part IV, Item 3(d) of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 3(d) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.
334. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 3(d) of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 3(d)?

**D. Connectivity, Order Entry, and Co-location**

Part IV Item 4(a) of proposed Form ATS-N would require the NMS Stock ATS to describe the means by which subscribers or other persons connect to the NMS Stock ATS and

enter orders or other trading interest on the NMS Stock ATS (e.g., directly, through a Financial Information eXchange (“FIX”) connection to the ATS, or indirectly, through the broker-dealer operator’s SOR, or any intermediate functionality, algorithm, or sales desk). This item also would require an NMS Stock ATS to describe any differences if the terms and conditions for connecting and entering orders or other trading interest on the NMS Stock ATS are not the same for all subscribers and persons.

Based on Commission experience reviewing Forms ATS, subscribers send orders or other trading interest to the NMS Stock ATS both directly and indirectly. A direct method of sending orders or other trading interest to an ATS that trades NMS stocks, for example, may include the use of the FIX Protocol. The FIX Protocol allows subscribers to enter orders or other trading interest into the ATS without an intermediary. To the extent that a subscriber connects to the NMS Stock ATS by way of a FIX connection and an order sent by that subscriber passes through an intermediate application or functionality on its way to the NMS Stock ATS, the NMS Stock ATS should identify the application or functionality and provide a description of its purpose.<sup>457</sup> One example of an indirect method of sending orders or other trading interest to an NMS Stock ATS is sending orders or other trading interest to the broker-dealer operator, which may then use its SOR (or similar functionality) or algorithm to send such orders or other trading interest to the NMS Stock ATS.

The disclosures regarding the direct or indirect means of order entry could be important to subscribers because they would provide information about the possible methods to reach the

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<sup>457</sup> The Commission notes that, in this example, given that the intermediate application or functionality has access to a subscriber’s order information, the NMS Stock ATS should take appropriate measures to protect the confidentiality of such information pursuant to Rule 301(b)(10) of Regulation ATS.

NMS Stock ATS and applicable system requirements necessary to send orders or other trading interest to the NMS Stock ATS. This information would also alert subscribers to the NMS Stock ATS as to whether trading interest can be entered on the NMS Stock ATS through the broker-dealer operator, which would allow subscribers to assess any potential advantages that orders sent through the broker-dealer operator may have with respect to other subscribers on the NMS Stock ATS.<sup>458</sup> The Commission would find the information required by this item useful to understanding how trading interest moves from persons to possible trading centers and in evaluating any potential conflicts of interest presented between the broker-dealer operator and the NMS Stock ATS in how orders are entered onto the NMS Stock ATS.

The disclosure of the information required for order entry on the NMS Stock ATS, such as limit price, size, and/or side of the market, would inform all subscribers to the NMS Stock ATS about how to transmit orders or other trading interest to the NMS Stock ATS. The Commission preliminarily believes that understanding this information may expedite the order entry process of subscribers. The Commission, as part of its monitoring of developments in market structure, also could use this disclosure to better understand what information allows for the interaction of trading interest.

The Commission preliminarily believes that requiring NMS Stock ATSs to disclose any differences in the terms and conditions for connecting and entering orders or other trading interest on the NMS Stock ATS are not the same for all subscribers and persons would allow market participants to source the various order entry procedures offered by NMS Stock ATSs as

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<sup>458</sup> But see supra notes 92-95 and 425-427 and accompanying text (discussing the fair access requirements of Regulation ATS).

part of evaluating an NMS Stock ATS as a potential destination for them to route their orders for execution.

Request for Comment

335. Do you believe the Commission should require the disclosure of the information on Part IV, Item 4(a) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
336. Do you believe Part IV, Item 4(a) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to the means by which subscribers or other persons connect to the NMS Stock ATS and enter orders or other trading interest on the NMS Stock ATS? Please explain.
337. Is it sufficiently clear what information would be required by Part IV, Item 4(a) of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
338. What are the direct and indirect means through which subscribers and other persons can send orders or other trading interest to the NMS Stock ATS? Do you believe there any means for which the Commission should specifically request information in Part IV, Item 4(a) of proposed Form ATS-N? If so, please explain how those means to send orders or other trading interest are used by subscribers and other persons.
339. Do you believe there are any methods of sending orders or other trading interest to NMS Stock ATSs that are more advantageous than others? If so, please

explain how such methods provide advantages to subscribers or other persons who use them. Should those advantages, if any, be specifically disclosed?

340. Do you believe there is other information that market participants might find relevant or useful regarding the means by which subscribers can send orders or other trading interest to the NMS Stock ATS? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
341. Do you believe there is any information that would be required by Part IV, Item 4(a) of Proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.
342. Do you believe that the information that would be required by Part IV, Item 4(a) of proposed Form ATS-N could be important to market participants in assessing any potential advantages that orders sent through the broker-dealer operator may have over other market participants on the NMS Stock ATS? Why or why not? Please support your arguments.
343. Do you believe that the information that would be required by Part IV, Item 4(a) of proposed Form ATS-N would be important to market participants when deciding whether to trade on an NMS Stock ATS and would assist them in devising appropriate trading strategies to help accomplish their investing or trading objectives? Why or why not? Please support your arguments.
344. What are the potential costs and benefits of disclosing the information required by Part IV, Item 4(a) of proposed Form ATS-N? Would the proposed disclosures in

Part IV, Item 4(a) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.

345. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 4(a) of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 4(a)?

Part IV Item 4(b) of proposed Form ATS-N would require that the NMS Stock ATS describe any co-location services or any other means by which any subscriber or other persons may enhance the speed by which to send or receive orders, trading interest, or messages to or from the NMS Stock ATS and the terms and conditions of co-location services. If the terms and conditions of the co-location services are not the same for all subscribers and persons, Part IV, Item 4(b) would require the NMS Stock ATS to describe any differences. Co-location is the placement of a user's systems in close physical proximity to the trading and execution system of a trading venue to reduce latency and enhance speed. The description of co-location services that could enhance the speed of orders and messages and the terms and conditions thereof would allow subscribers to evaluate these services and determine whether they would like to subscribe to such services if available. Moreover, subscribers and potential subscribers would know that others can use a co-location service even if they determine not to use it themselves, which would

assist them in devising appropriate trading strategies if they choose to participate.<sup>459</sup> For instance, a subscriber could choose certain types of orders or trading strategies with the knowledge that other subscribers have enhanced speeds for submitting trading interest through the use of the NMS Stock ATS's connectivity or co-location services.

The proposed requirement that the NMS Stock ATS describe any differences in the terms and conditions of an NMS Stock ATS's co-location services among subscribers or other persons also could help inform the trading strategies chosen by subscribers. Information on such connectivity and co-location options would further the Commission's understanding of the dynamics of the markets and overall market structure for NMS stocks. In addition, this information would allow the Commission to evaluate whether the NMS Stock ATS is unreasonably prohibiting or limiting any person with respect to the access to services offered by the NMS Stock ATS in contravention of Rule 301(b)(5) of Regulation ATS for those NMS Stock ATSs that have surpassed the applicable trading volume thresholds.

#### Request for Comment

346. Do you believe the Commission should require the disclosure of the information on Part IV, Item 4(b) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
347. Do you believe Part IV, Item 4(b) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS

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<sup>459</sup> See SIFMA letter #1, supra note 194 and accompanying text (stating its belief that "added disclosure about co-location and other market access arrangements would be beneficial to market participants"); Morgan Stanley letter, supra note 197 and accompanying text (stating that it received questions from customers specific to dark pools related to the co-location of servers).

Stock ATS related to co-location services or any other means by which any subscriber or other persons may enhance the speed by which to send or receive orders, trading interest, or messages to or from the NMS Stock ATS? Please explain.

348. Is it sufficiently clear what information would be required by Part IV, Item 4(b) of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
349. Do you believe there is other information that market participants might find relevant or useful regarding co-location services by which a subscriber may enhance the speed that it may submit orders or send and receive messages? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
350. Do you believe there is any information that would be required by Part IV, Item 4(b) of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.
351. Do believe that the information that would be required by Part IV, Item 4(b) of proposed Form ATS-N would be useful to market participants when deciding whether to trade on an NMS Stock ATS and would assist them in devising appropriate trading strategies to help accomplish their investing or trading objectives? Why or why not? Please support your arguments.

352. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 4(b) of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 4(b)?

353. What are the potential costs and benefits of disclosing the information required by Part IV, Item 4(b) of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 4(b) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.

**E. Segmentation of Order Flow and Notice About Segmentation**

Part IV, Item 5(a) of proposed Form ATS-N would require an NMS Stock ATS to describe any segmentation of orders or other trading interest on the NMS Stock ATS (e.g., classification by type of participant, source, nature of trading activity). Part IV, Item 5(a) would also require the NMS Stock ATS to describe the segmented categories, the criteria used to segment these categories, and procedures for determining, evaluating, and changing segmented categories. If the segmented categories, the criteria used to segment these categories, and any procedures for determining, evaluating or changing segmented categories are not the same for all subscribers and persons, this item would require an NMS Stock ATS to describe any differences.

Based on Commission experience, some NMS Stock ATSs segment order flow entered on the NMS Stock ATS according to various categories and allow subscribers to select the type of persons or order flow they want to trade or not trade against. An NMS Stock ATS may segment trading interest by type of participant (e.g., buy-side or sell-side firms, proprietary

trading firms, agency-only firms, firms above or below certain assets under management thresholds). For example, buy-side or institutional order flow may seek to only trade against other buy-side or institutional order flow, or may seek to avoid trading against proprietary trading firms or so-called high frequency trading firms. When segmenting by source, an NMS Stock ATS may look to the underlying source of the trading interest in the case of trading interest that is intermediated, such as the trading interest of retail customers. Some NMS Stock ATSs segment by the nature of the trading activity, which could include segmenting by patterns of behavior, time horizons of traders, or the passivity or aggressiveness of trading strategies. NMS Stock ATSs might elect to use some combination of these criteria or other criteria altogether.

This item would require that an NMS Stock ATS disclose the segmented categories, the criteria used to segment these categories, and procedures for determining, evaluating, and changing segmented categories. This would include, for example, any modification or overriding of an existing segmented category and a description of how existing subscribers in the segmented category would be handled and notified. This item would provide market participants with an understanding of the categories of order flow or types of market participants with which they may interact and allow them to both assess the consistency of a segmented group and determine whether the manner in which the trading interest is segmented comports with its views of how certain trading interest should be categorized. Disclosure of the procedures and criteria used to segment categories would allow a market participant to determine whether its view of what constitutes certain trading interest it wants to seek or avoid is classified in the same way by the NMS Stock ATS. For example, a subscriber may find it useful to understand the metrics or criteria an NMS Stock ATS uses to categorize high frequency trading firms so that it can

compare the criteria used by the NMS Stock ATS with its view of what constitutes a high frequency trading firm, and thus be able to successfully trade against or avoid such trading interest. Similarly, information regarding the procedures applicable to trading among segmented categories would allow market participants to evaluate whether they can successfully trade against or avoid the segments of trading interest they desire.

In addition, disclosure of any differences in the segmentation among participants would allow subscribers to more clearly note if certain persons are, for instance, not subject to segmentation in the same way as other persons, or not subject to segmentation at all and able to trade against all order flow. All participants would have access to the same information as to how the NMS Stock ATS segments order flow, and whether the segmentation criteria are applied by the NMS Stock ATS uniformly.<sup>460</sup> These disclosures would help the Commission understand the categories and manner in which persons and order flow (or both) are segmented across NMS Stock ATSs and could aid the Commission in its oversight of the markets including, for example, its evaluation of whether segmentation could facilitate or hinder market participants from achieving their investing or trading objectives. The Commission is not proposing to prohibit NMS Stock ATSs from segmenting their order flow;<sup>461</sup> the Commission is instead proposing

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<sup>460</sup> See Blackrock letter, supra note 186 and accompanying text (stating mandatory ATS disclosure should include greater detail on how the platform matches orders between client segments); Consumer Federation of America letter, supra note 187 and accompanying text (stating that Form ATS should require ATSs to provide “critical details about . . . segmentation” because “the information will allow market participants . . . to assess whether an ATS’s terms of access and service are such that it makes sense to trade on that venue”).

<sup>461</sup> However, an ATS that crossed the fair access threshold and wished to segment its order flow could do so only in accordance with the fair access provisions of existing Rule 301(b)(5) of Regulation ATS.

only that an NMS Stock ATS disclose to market participants and the Commission how they segment their order flow.

Request for Comment

354. Do you believe the Commission should require the disclosure of the information on Part IV, Item 5(a) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
355. Do you believe Part IV, Item 5(a) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to segmentation of orders or other trading interest on the NMS Stock ATS? Please explain.
356. Is it sufficiently clear what information would be required by Part IV, Item 5(a) of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
357. Do you believe there is other information that market participants might find relevant or useful regarding segmentation of order flow on the NMS Stock ATS? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
358. Do you believe there is any information that would be required by Part IV, Item 5(a) of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.

359. Do you believe there are any forms or types of order segmentation that would not be captured by Part IV, Item 5(a) of proposed Form ATS-N or should be addressed separately? If so, please provide a detailed explanation of how orders are segmented under such functionalities on NMS Stock ATSs.
360. What are the potential costs and benefits of disclosing the information required by Part IV, Item 5(a) of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 5(a) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.
361. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 5(a) of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 5(a)?

Part IV, Item 5(b) of proposed Form ATS-N would require the NMS Stock ATS to state whether the NMS Stock ATS informs subscribers or persons about the segmentation category that a subscriber or a person is assigned and to describe any notice provided to subscribers or persons about the segmentation category that they are assigned and the segmentation identified in Part IV, Item 5(a), including the content of any notice and the means by which any notice is communicated. Also, an NMS Stock ATS would be required to describe any differences if the notice is not the same for all subscribers and persons. As discussed above, an NMS Stock ATS can elect to segment its order flow entered on the NMS Stock ATS according to various categories and allow subscribers and other persons to select the type of persons or order flow

they want to trade or not trade against. Based on the experience of the Commission and its staff, ATSS provide subscribers with limited information about how they segment order flow and do not always inform subscribers about the categories into which they are segmented. A market participant that is unaware of its segmented category may not know about the order flow it is trading against, and therefore, the Commission preliminarily believes that market participants trading on an NMS Stock ATS would want to know about their assigned segmented categories and understand how those categories were determined.<sup>462</sup> The category into which a subscriber is placed also informs its decision of where to trade because it could affect the contra-side trading interest available to them to trade against. Item 5(b) is therefore designed to inform market participants about the potential information that the NMS Stock ATS may provide to inform them about such segmentation, particularly with respect to whether the NMS Stock ATS informs subscribers about how it assigns a participant to a segmented category, as well as any differences in the notice provided to subscribers. The Commission preliminarily believes that market participants would find it useful to understand how they will be alerted about segmentation on an NMS Stock ATS before deciding whether or not to subscribe to the NMS Stock ATS.

Request for Comment

362. Do you believe the Commission should require the disclosure of the information on Part IV, Item 5(b) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.

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<sup>462</sup> See supra notes 171, 186, 198, 199 and accompanying text.

363. Do you believe Part IV, Item 5(b) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to informing subscribers or persons about the segmentation category that a subscriber or a person is assigned? Please explain.
364. Is it sufficiently clear what information would be required by Part IV, Item 5(b) of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
365. Do you believe there is any information that would be required by Part IV, Item 5(b) of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.
366. Do you believe there is any specific information that the Commission should require NMS Stock ATSs to disclose to each subscriber with regard to how it segments each subscriber's orders? If so, explain what information and why. Please support your arguments.
367. Do you believe transparency with respect to how an NMS Stock ATS notifies subscribers regarding how those subscribers' trading interests are segmented is useful to market participants when deciding whether to trade on the NMS Stock ATS and would assist them in devising appropriate trading strategies to help accomplish their investing or trading objectives? If not, why? Please support your arguments.
368. What are the potential costs and benefits of disclosing the information required by Part IV, Item 5(b) of proposed Form ATS-N? Would the proposed disclosures in

Part IV, Item 5(b) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.

369. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 5(b) of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 5(b)?

Part IV, Item 5(c) of proposed Form ATS-N would require an NMS Stock ATS to describe any means and the circumstances by which a subscriber, the broker-dealer operator, or any of its affiliates may designate an order or trading interest submitted to the NMS Stock ATS to interact or not to interact with specific orders, trading interest, or persons on the NMS Stock ATS (e.g., designating an order or trading interest to be executed against a specific subscriber) and how such designations affect order priority and interaction. Part IV, Item 5(c) would require the NMS Stock ATS to describe any means by which subscribers can seek or avoid certain executions against certain orders, persons, or trading interest. In response to this item, an NMS Stock ATS would be required to disclose, for example, any circumstances by which an NMS Stock ATS allows persons to designate an order submitted to the NMS Stock ATS to interact with specific orders resting on the NMS Stock ATS. The NMS Stock ATS would need to describe this process and how such order preferencing works with other rules governing order priority and interaction. The response to this item also would also be required to include a description of any means by which a subscriber could avoid executing against any order, person, or trading interest. For instance, an NMS Stock ATS would need to describe any mechanisms by

which a person could avoid executing against its own orders or orders of its affiliates on the NMS Stock ATS.

The Commission preliminarily believes that it is important for market participants to understand whether – and how – they may designate their orders or other trading interest to avoid interacting with specific orders, trading interest, or persons on an NMS Stock ATS. The Commission preliminarily believes that this understanding would help market participants better evaluate the NMS Stock ATS as a potential trading venue. For instance, if a market participant seeks to avoid interacting with an order type that is commonly employed as part of certain trading strategies, the Commission preliminarily believes that the disclosures required under Item 5(c) would better enable that market participant to determine whether submitting order flow to a particular NMS Stock ATS would allow it to carry out its own trading strategy. Similarly, if a market participant would find it desirable to be able to designate an order submitted to the NMS Stock ATS to interact with specific orders resting on an NMS Stock ATS's order book, the Commission preliminarily believes that the information required by Item 5(c) would inform that market participant whether – and how – it can do so on a particular NMS Stock ATS, thereby assisting that market participant when it evaluates that NMS Stock ATS as a potential trading venue.

Request for Comment

370. Do you believe the Commission should require the disclosure of the information on Part IV, Item 5(c) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
371. Do you believe Part IV, Item 5(c) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS

Stock ATS related to the means and the circumstances by which a subscriber, the broker-dealer operator, or any of its affiliates may designate an order or trading interest submitted to the NMS Stock ATS to interact or not to interact with specific orders, trading interest, or persons on the NMS Stock ATS? Please explain.

372. Do you believe there is other information that market participants might find relevant or useful regarding the means and the circumstances by which a subscriber, the broker-dealer operator, or any of its affiliates may designate an order or trading interest submitted to the NMS Stock ATS to interact or not to interact with specific orders, trading interest, or persons on the NMS Stock ATS? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N.

Please support your arguments.

373. Is it sufficiently clear what information would be required by Part IV, Item 5(c) of proposed Form ATS-N? Should the item be refined in any way? If so, how?

Please be specific.

374. Do you believe there is any information that would be required by Part IV, Item 5(c) of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.

375. Should the requirement to describe the means by which persons, orders, or trading interest may be sought or avoided on an NMS Stock ATS be refined in any way?

Please be specific.

376. Does the process for seeking or avoiding specific orders, persons, or trading interest raise any other market structure issues or concerns that the Commission should consider? Please be specific.
377. What are the potential costs and benefits of disclosing the information required by Part IV, Item 5(c) of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 5(c) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.
378. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 5(c) of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 5(c)?

**F. Display of Order and Trading Interest**

Part IV, Item 6(a) of proposed Form ATS-N would require that an NMS Stock ATS describe any means and circumstances by which orders or other trading interest on the NMS Stock ATS are displayed or made known outside the NMS Stock ATS and the information about the orders and trading interest that are displayed. Also, if the display of orders or other trading interest is not the same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences. Part IV, Item 6(b) of proposed Form ATS-N would also require the NMS Stock ATS to identify the subscriber(s) or person(s) (in the case of a natural person, to identify only the position or title) to whom the orders and trading interest are displayed or otherwise made known.

As discussed more fully above,<sup>463</sup> most NMS Stock ATSS do not publicly display quotation data and are commonly referred to as “dark pools.” The Commission preliminarily believes that market participants generally are very sensitive to precisely how and when their trading interest is displayed or otherwise made known outside the NMS Stock ATS. The Commission is concerned that market participants currently may not know the extent to which their trading interest sent to ATSS is displayed outside those ATSS. Accordingly, for any NMS Stock ATSS that display some or all of the trading interest on their systems, Part IV, Item 6 of proposed Form ATS-N would require the NMS Stock ATS to identify the subscriber(s) or person(s) to whom orders or other trading interest information is displayed or otherwise made known, the means and circumstances by which orders or other trading interest are displayed or made known, and the contents of that information. Because NMS Stock ATSS that are also ECNs may differ in how and where orders or other trading interest are displayed, the Commission preliminarily believes this item would clarify for market participants and the Commission exactly how such display may occur. In addition, an NMS Stock ATS would need to disclose arrangements, whether formal or informal (oral or written) to the extent they exist, with third parties to display the NMS Stock ATS’s trading interest outside of the NMS Stock ATS, such as IOIs from the NMS Stock ATS’s subscribers being displayed on vendor systems, or arrangements with third parties to transmit IOIs between subscribers.

The Commission preliminarily believes that when an NMS Stock ATS sends electronic messages outside of the NMS Stock ATS that expose the presence of orders or other trading interest on the NMS Stock ATS, it is displaying or making known orders or other trading interest

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<sup>463</sup> See supra note 123 and accompanying text.

on the NMS Stock ATS. For instance, an NMS Stock ATS may send to subscribers or other persons a direct data feed from the NMS Stock ATS that contains real-time information about current quotes, orders or other trading interest on the NMS Stock ATS. Accordingly, it would be responsive to this item for the NMS Stock ATS to disclose the circumstances under which the NMS Stock ATS would send these messages, the persons that received them, and the information contained in the messages, including the symbol or any other information relating to trading interest on the NMS Stock ATS. The NMS Stock ATS would need to disclose the information required by this item, including the exact content of the information, such as symbol, price, size, attribution, or any other information made known. The Commission preliminarily believes that disclosures in response to this item are important because the information disclosed would provide market participants with advance notice of the potential display of their orders or other trading interest outside of the NMS Stock ATS.<sup>464</sup> The Commission preliminarily believes that market participants, whose trading strategies are sensitive to how and to whom their orders and trading interest are displayed, would use the information disclosed under Item 6 to evaluate whether routing orders to a particular NMS Stock ATS would be consistent with their respective strategies.

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<sup>464</sup> See Morgan Stanley letter, supra note 197 and accompanying text (stating customers questioned it about whether its dark pool is truly dark); Bloomberg Tradebook letter, supra note 190 and accompanying text (recommending that the Commission ask ATSs to complete a questionnaire that would include questions relating to the sharing of orders or order information with affiliates or other trading venues by the ATS).

Request for Comment

379. Do you believe the Commission should require the disclosure of the information on Part IV, Item 6 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific
380. Do you believe Part IV, Item 6 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to the means and circumstances by which orders or other trading interest on the NMS Stock ATS are displayed or made known outside the NMS Stock ATS and the information about the orders and trading interest that are displayed? Please explain.
381. What are the means through which NMS Stock ATSs currently display or make known trading interest? Do you believe any of these means raise any concerns? If so, why? Please support your arguments. Do you believe that Part IV, Item 6 of proposed Form ATS-N would mitigate any of those concerns through the disclosure of responsive information? Why or why not? Please support your arguments.
382. Is it sufficiently clear what information would be required by Part IV, Item 6 of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
383. Do you believe there is other information that market participants might find relevant or useful regarding orders or other trading interest on the NMS Stock ATS that are displayed or otherwise made known outside the NMS Stock ATS? If so, describe such information and explain whether, and if so why, such

information should be required to be provided under proposed Form ATS-N.

Please support your arguments.

384. Do you believe there is any information that would be required by Part IV, Item 6 of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.
385. What are the potential costs and benefits of disclosing the information required by Part IV, Item 6 of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 6 of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.
386. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 6 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 6?

#### **G. Trading Services**

Part IV, Item 7(a) of proposed Form ATS-N would require an NMS Stock ATS to describe the means or facilities used by the NMS Stock ATS to bring together the orders of multiple buyers and sellers, including the structure of the market (e.g., crossing system, auction market, limit order matching book). If the use of these means or facilities are not the same for all subscribers and persons, the NMS Stock ATS would also be required to describe any differences.

This item is primarily designed to inform market participants and the Commission about an NMS Stock ATS's market and the facilities and mechanisms that it uses to match counterparties. Part IV, Item 7(a) of proposed Form ATS-N would require a description, with specificity, of the facilities and mechanisms into which subscribers enter orders and how orders entered into these facilities and mechanisms would interact. The Commission has previously explained that a trading center brings together orders when orders entered into the system for a given security have the opportunity to interact with other orders entered into the system for the same security.<sup>465</sup> For instance, a trading center brings together orders if it displays, or otherwise represents, trading interests entered on the system, such as a consolidated quote screen, to system users.<sup>466</sup> Furthermore, a trading center also brings together orders if it receives subscribers' orders centrally for future processing and execution, such as part of a limit order matching book that allows subscribers to display buy and sell orders in particular securities and to obtain execution against matching orders contemporaneously entered or stored in the system.<sup>467</sup> Additionally, as explained above, to qualify for the Rule 3a1-1(a)(2) exemption from the statutory definition of "exchange," an ATS must bring together the orders of multiple buyers and sellers.<sup>468</sup>

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<sup>465</sup> See Regulation ATS Adopting Release, supra note 7, at 70849.

<sup>466</sup> See id.

<sup>467</sup> See id.

<sup>468</sup> See id. The Commission emphasized in the Regulation ATS Adopting Release that the mere interpositioning of a designated counterparty as riskless principal for settlement purposes after the purchasing and selling counterparties to a trade have been matched would not, by itself, mean that the system does not have multiple buyers and sellers. See id. Additionally, systems in which there is only a single seller, such as systems that permit issuers to sell their own securities to investors, would not be included within Rule 3b-16. See id.

Based on Commission experience, ATSs that trade NMS stocks use various types of trading mechanisms. For example, many ATSs bring together multiple buyers and sellers using limit order matching systems. Other ATSs use crossing mechanisms that allow participants to enter unpriced orders to buy and sell securities, with the ATS's system crossing orders at specified times at a price derived from another market.<sup>469</sup> Some ATSs use an auction mechanism that matches multiple buyers and sellers by first pausing execution in a certain security for a set amount of time, during which the ATS's system seeks out and/or concentrates liquidity for the auction; after the trading pause, orders will execute at either a single auction price or according to the priority rules for the auction's execution. Furthermore, some ATSs use a blotter scraping functionality, which may inform the ATS's system about the orders placed on a participant's order management system, but not yet entered into the ATS; the ATS or broker-dealer operator oftentimes can automatically generate those orders and enter them into the ATS on behalf of the subscriber, in accordance with the relevant terms and conditions, when certain contra-side trading interest exists in the ATS.

The Commission preliminarily believes that the disclosures required under Part IV, Item 7(a) would be useful to market participants when evaluating whether or not to route orders to a particular NMS Stock ATS. At times, market participants may route orders to a trading venue with certain characteristics to accomplish a particular trading strategy. For instance, a market participant aiming to execute a block transaction may seek out a trading platform that operates a block crossing network with specialized size discovery mechanisms and controls for information leakage. At the same time, a different market participant may seek to use an NMS Stock ATS's

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<sup>469</sup> See Regulation ATS Adopting Release, supra note 7, at 70849 n.37.

auction function if that market participant believes the auction process would provide the best opportunity for price discovery or price improvement. Accordingly, the Commission preliminarily believes that disclosure of the information that would be required under Item 7(a) of proposed Form ATS-N would better enable market participants to evaluate an NMS Stock ATS as a potential destination for them to route their orders. In addition, this information also would assist the Commission to fully evaluate the facilities and mechanisms that consist of the NMS Stock ATS and whether an NMS Stock ATS meets the requirements of Rule 3b-16 that it is bringing together the orders for securities of multiple buyers and sellers.<sup>470</sup>

Request for Comment

387. Do you believe the Commission should require the disclosure of the information on Part IV, Item 7(a) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
388. Do you believe Part IV, Item 7(a) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to the means or facilities used by the NMS Stock ATS to bring together the orders of multiple buyers and sellers, including the structure of the market? Please explain.
389. Is it sufficiently clear what information would be required by Part IV, Item 7(a) of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.

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<sup>470</sup> See 17 CFR 240.3b-16(a)(1).

390. Do you believe there is other information that market participants might find relevant or useful regarding the means or facilities used by the NMS Stock ATS to bring together the orders of multiple buyers and sellers? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
391. Do you believe there is any information that would be required by Part IV, Item 7(a) of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.
392. Are there particular means or facilities for bringing together the orders of multiple buyers and sellers on which the Commission should request information specifically that is not included as a component under Part IV, item 7(a) of proposed Form ATS-N?
393. What are the potential costs and benefits of disclosing the information required by Part IV, Item 7(a) of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 7(a) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.
394. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 7(a) of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could

this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 7(a)?

Part IV, Item 7(b) of Form ATS-N would require an NMS Stock ATS to describe the established, non-discretionary methods that dictate the terms of trading among multiple buyers and sellers on the facilities of the NMS Stock ATS, including rules and procedures governing the priority, pricing methodologies, allocation, matching, and execution of orders and other trading interest. If these rules and procedures are not the same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences.

Part IV, Item 7(b) of proposed Form ATS-N is primarily designed to inform market participants about how orders interact on an NMS Stock ATS upon being entered into the system. Item 7(b) would require a description, with specificity, of all rules and procedures relevant to order interaction and execution, such as those addressing order priority, pricing methodologies, allocation, matching, and execution of orders and other trading interest. The Commission previously explained in the Regulation ATS Adopting Release that use of established, non-discretionary methods could include operation of a trading facility or the setting of rules governing the trading of subscribers.<sup>471</sup> For example, the Commission considers the use of an algorithm by an electronic trading system, which sets trading procedures and priorities, to be a trading facility that uses established, non-discretionary methods.<sup>472</sup> Similarly, the

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<sup>471</sup> See Regulation ATS Adopting Release, supra note 7, at 70851-52.

<sup>472</sup> See id. at 70851.

Commission has previously stated that rules imposing execution priorities, such as time and price priority rules, would be “established, non-discretionary methods.”<sup>473</sup>

Based on Commission experience, NMS Stocks ATSs employ various terms and conditions under which orders interact and match. As noted above, some NMS Stock ATSs may offer price-time priority to determine how to match orders (potentially with various exceptions), while other NMS Stock ATSs may offer midpoint-only matching with time priority. Some NMS Stock ATSs might also take into account other factors to determine priority. For example, an NMS Stock ATS may assign either a lower or higher priority to an order entered by a subscriber in a certain class (e.g., orders of proprietary traders or retail investors) or routed from a particular source (e.g., orders routed by the broker-dealer operator’s SOR (or similar functionality) or algorithm) when compared to an equally priced order entered by a different subscriber or via a different source. Furthermore, in the Commission’s experience, an NMS Stock ATS might elect to apply different priority rules for matching conditional orders than it does for matching other order types.

Part IV, Item 7(c) of proposed Form ATS-N would require an NMS Stock ATS to describe any trading procedures related to price protection mechanisms, short sales, locked-crossed markets, the handling of execution errors, time-stamping of orders and executions, or price improvement functionality. If the trading procedures are not the same for all subscribers and persons, the NMS Stock ATS would also be required to describe any differences. Some ATSs that trade NMS stocks apply various methods to determine an execution price based on the circumstances of the match. For example, an ATS may price an execution of a midpoint pegged

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<sup>473</sup>

See id. at 70852.

order with a limit or market order at the midpoint of the NBBO. An ATS executing a match of two limit orders, or a limit and market order, might price the execution at or within the NBBO, with the possibility of offering the limit order(s) price improvement. On the other hand, an ATS that operates a block crossing network, with specialized size discovery mechanisms, might calculate a volume-weighted average price after the final size of the execution has been determined.

In the Commission's experience, NMS Stock ATSs have also adopted other trading procedures governing the execution of orders, which the NMS Stock ATS would be required to explain under Part IV, Item 7(c) of proposed Form ATS-N. For instance, an NMS Stock ATS might elect to use price protections to re-price orders or prevent their execution under certain circumstances, such as Limit Up Limit Down price bands pursuant to the National Market System Plan to Address Extraordinary Market Volatility ("LULD Plan").<sup>474</sup> An NMS Stock ATS might also permit short sales to be executed on its system and would thus be required to configure its system to comply with federal securities laws related to short sales, including Regulation SHO.<sup>475</sup> Additionally, an NMS Stock ATS could have rules and procedures governing and/or precluding the execution of orders in a locked or crossed market. If an NMS Stock ATS has any procedures governing the handling of execution errors, such as the use of an

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<sup>474</sup> See Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012) (File No. 4-631) ("LULD Approval Order"). The registered national securities exchanges and FINRA filed the LULD Plan to create a market-wide limit up-limit down mechanism to address extraordinary market volatility in NMS Stocks. See *id.* at 33500. The Plan sets forth procedures that provide for market-wide limit up-limit down requirements that would be designed to prevent trades in individual NMS Stocks from occurring outside of the specified price bands. See *id.*

<sup>475</sup> 17 CFR 242.200-204.

error account by the NMS Stock ATS, it would be required to explain those procedures in Item 7(c).

Furthermore, under Part IV, Item 7(c) of proposed Form ATS-N, an NMS Stock ATS would also be required to describe any protocols for time-stamping orders and executions to ensure compliance with the Exchange Act and the rules and regulations thereunder and any execution procedures related to price improvement. For example, if an NMS Stock ATS has procedures to reprice orders under its price protection mechanisms, to reprice short sale orders to ensure compliance with Regulation SHO, or to reprice orders due to price-sliding order types (such as certain pegged order types), it would be required to explain when it creates new timestamps for such re-priced orders.<sup>476</sup> In addition, any functionality or mechanism available on the NMS Stock ATS that allows for price improvement would also need to be described in response to this item.

The Commission preliminarily believes that information about how an NMS Stock ATS prices and matches orders is useful to market participants' and the Commission's understanding of that trading center's operation. The Commission preliminarily believes that the information required under Part IV, Items 7(b) and 7(c) of proposed Form ATS-N would allow market participants to evaluate the terms and conditions under which their orders will interact and execute on an NMS Stock ATS, and would thus provide them with a better opportunity to determine whether that NMS Stock ATS is the appropriate trading destination for their orders. For example, a market participant whose order would be given a higher priority on an NMS

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<sup>476</sup> Additionally, if subscriber orders are routed from the NMS Stock ATS and are not filled, or filled only in part on the NMS Stock ATS, the Commission preliminarily believes that the NMS Stock ATS should describe how such orders are time stamped for priority purposes.

Stock ATS based on its subscriber class may choose to first route its order to that venue, whereas a market participant seeking to enter a conditional order may choose to route an order based on an NMS Stock ATS's specific priority rules governing conditional orders. Likewise, market participants likely would want to know whether an NMS Stock ATS applies price protection mechanisms, or other standards, that could re-price an order or prevent it from executing under certain conditions. In addition, the Commission preliminarily believes that the information provided in response to Items 7(a), 7(b), and 7(c) would allow the Commission to more easily evaluate whether the entity that filed the proposed Form ATS-N meets the criteria of Rule 3b-16 and the definition of an NMS Stock ATS.

Request for Comment

395. Do you believe the Commission should require the disclosure of the information on Part IV, Items 7(b) and 7(c) of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
396. Do you believe Part IV, Item 7(b) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS related to the established, non-discretionary methods that dictate the terms of trading among multiple buyers and sellers on the facilities of the NMS Stock ATS, including rules and procedures governing the priority, pricing methodologies, allocation, matching, and execution of orders and other trading interest? Please explain.
397. Do you believe Part IV, Item 7(c) of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS regarding the trading procedures related to price protection

mechanisms, short sales, locked-crossed markets, the handling of execution errors, time-stamping of orders and executions, or price improvement functionality? Please explain.

398. Is it sufficiently clear what information would be required by Part IV, Items 7(b) and 7(c) of proposed Form ATS-N? Should these items be refined in any way? If so, how? Please be specific.
399. Do you believe there is other information that market participants might find relevant or useful regarding the established non-discretionary methods that dictate the terms of trading among multiple buyers and sellers on the market or facilities of an NMS Stock ATS? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
400. Do you believe there is other information that market participants might find relevant or useful regarding trading procedures related to price protection mechanisms, short sales, locked-crossed markets, the handling of execution errors, time-stamping of orders and executions, or price improvement functionality on an NMS Stock ATS? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
401. Do you believe there is any information that would be required by Part IV, Items 7(b) and 7(c) of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons,

trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.

402. Are there any aspects of the non-discretionary methods that dictate the terms of trading among buyers and sellers on which the Commission should specifically require information that is not included as a component under Part IV, Item 7(b) of proposed Form ATS-N?
403. What are the potential costs and benefits of disclosing the information required by Part IV, Items 7(b) and 7(c) of proposed Form ATS-N? Would the proposed disclosures in Part IV, Items 7(b) and 7(c) of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.
404. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Items 7(b) and 7(c) of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Items 7(b) and 7(c)?

#### **H. Suspension of Trading, System Disruption or Malfunction**

Part IV, Item 8 of proposed Form ATS-N would require an NMS Stock ATS to describe any procedures governing trading in the event the NMS Stock ATS suspends trading or experiences a system disruption or malfunction. In addition, if the procedures governing trading during a suspension or system disruption or malfunction are not the same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences. This item is designed to inform market participants of whether, among other things, an NMS Stock ATS will

continue to accept orders after suspension or system malfunction or disruption occurs, whether the NMS Stock ATS routes, holds, or continues to execute orders resting in the system prior to the disruption, and the type of notice the NMS Stock ATS provides to subscribers and other market participants during a suspension or system disruption or malfunction. Examples of system disruptions would include, but are not limited to, internal software problems that prevent the NMS Stock ATS's system from opening or continuing trading,<sup>477</sup> a significant increase in volume that exceeds the ability of the trading system of the NMS Stock ATS to process incoming orders,<sup>478</sup> and the failure of the ability of the trading system of the NMS Stock ATS to receive NBBO or other external pricing information that is used in the system's pricing methodology.

The Commission preliminarily believes that information regarding an NMS Stock ATS's procedures on how orders may be handled during a suspension of trading or system disruption or malfunction would be useful to market participants because such an event might preclude the NMS Stock ATS from accepting and/or executing time sensitive orders and could impact the price the subscriber receives. The information about how an NMS Stock ATS would handle orders under such circumstances would better inform a subscriber's trading decisions at the time of such an event and thus help that subscriber accomplish its investing or trading objectives.

Information regarding the procedures for how an NMS Stock ATS would handle orders during a suspension of trading or system disruption or malfunction would also help the Commission better monitor the securities markets. The Commission has recently noted that

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<sup>477</sup> See SCI Adopting Release, supra note 17 at 72254-55 n.28.

<sup>478</sup> See id. at 72255 n.29.

given the speed and interconnected nature of the U.S. securities markets, a seemingly minor systems problem at a single entity can quickly create losses and liability for market participants, and spread rapidly across the national market system, potentially creating widespread damage and harm to market participants and investors.<sup>479</sup> Accordingly, it is important to fully understand what, if any, trading procedures an NMS Stock ATS would follow during a suspension of trading or system disruption or malfunction. The Commission preliminarily believes that the disclosures that would be required by Item 8 would help the Commission discover a potential violation of the federal securities laws and rules or regulations thereunder in a more expeditious manner than if the disclosures were not required. The Commission notes that it is not proposing to require NMS Stock ATSs to adopt specific procedures governing trading during a system disruption or malfunction as it did under Regulation SCI for certain significant-volume ATSs that trade NMS stocks or non-NMS stocks.<sup>480</sup> Rather, under Part IV, Item 8 of proposed Form ATS-N, the Commission is only requiring an NMS Stock ATS to disclose what procedures, if any, it follows during a suspension of trading or system disruption or malfunction on the NMS Stock ATS. Accordingly, the disclosure requirements under Item 8, similar to other items on proposed Form ATS-N, are intended to inform market participants of an NMS Stock ATS's procedures rather than impose any new procedural requirements on NMS Stock ATSs.

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<sup>479</sup> See id. at 72253.

<sup>480</sup> See supra notes 102-103 and accompanying text.

Request for Comment

405. Do you believe the Commission should require the disclosure of the information on Part IV, Item 8 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
406. Do you believe Part IV, Item 8 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS regarding any procedures governing trading in the event the NMS Stock ATS suspends trading or experiences a system disruption or malfunction? Please explain.
407. Is it sufficiently clear what information would be required by Part IV, Item 8 of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
408. Do you believe there is other information that market participants might find relevant or useful regarding procedures governing trading in the event an NMS Stock ATS suspends trading or experiences a system disruption or malfunction? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
409. Do you believe there is any information that would be required by Part IV, Item 8 of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.

410. What are the potential costs and benefits of disclosing the information required by Part IV, Item 8 of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 8 of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.

411. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 8 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 8?

#### **I. Opening, Reopening, and Closing Processes, and After Hours Procedures**

Part IV, Item 9 of proposed Form ATS-N would require an NMS Stock ATS to describe its opening, reopening, and closing processes, if any, and any after-hours trading procedures.

Part IV, Item 9(a) of proposed Form ATS-N would require an NMS Stock ATS to describe any opening and reopening processes, including how orders or other trading interest are matched and executed prior to the start of regular trading hours or following a stoppage of trading in a security during regular trading hours and how unexecuted orders or other trading interest are handled at the time the NMS Stock ATS begins regular trading at the start of regular trading hours or following a stoppage of trading in a security during regular trading hours. An NMS Stock ATS would also be required to describe any differences between pre-opening executions, executions following a stoppage of trading in a security during regular trading hours, and executions during regular trading hours. Part IV, Item 9(b) of proposed Form ATS-N would require a description of any closing process, including how unexecuted orders or other trading interest are handled at

the close of regular trading. An NMS Stock ATS would also be required to describe any differences between the closing executions and executions during regular trading hours. Part IV, Item 9(c) of proposed Form ATS-N would require a description of any after-hours trading procedures, including how orders and trading interest are matched and executed during after-hours trading. An NMS Stock ATS would also be required to describe any differences between the after-hours executions and executions during regular trading hours.

Part IV, Item 9 of proposed Form ATS-N is designed to inform market participants about whether an NMS Stock ATS uses any special procedures to match orders outside of regular trading hours and/or processes to set a single opening, reopening, or closing price to, for example, maximize liquidity and accurately reflect market conditions at the opening, reopening, or close of trading. The Commission notes that it is standard practice for national securities exchanges to conduct opening, reopening, and closing auctions, or similar procedures, to start and conclude the trading day, or reopen trading in a security during the trading day.<sup>481</sup> Furthermore, to facilitate their opening and closing processes, exchanges often permit members to enter orders specially designated to execute on the opening or closing.<sup>482</sup> The disclosures under this item would allow for comparisons between NMS Stock ATSs and exchanges.

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<sup>481</sup> See, e.g., New York Stock Exchange Rule 123D (setting forth the duties of NYSE Designated Market Maker when opening and reopening trading in a stock); New York Stock Exchange Rule 123C (setting forth the exchange's closing procedures); The Nasdaq Stock Market LLC Rule 4752 (setting forth rules for the Nasdaq Opening Cross); The Nasdaq Stock Market LLC Rule 4753 (setting forth rules for the Nasdaq Halt Cross); The Nasdaq Stock Market LLC Rule 4754 (setting forth rules for the Nasdaq Closing Cross); BATS Exchange Rules 11.23 and 11.24 (setting forth the exchange's procedures for openings, closings and auctions following a trading halt).

<sup>482</sup> See, e.g., New York Stock Exchange Rule 13 (defining Market-on-Open, Market-on-Close, Limit-on-Open, and Limit-on-Close, and Closing Offset order types); The Nasdaq Stock Market LLC Rule 4752 (a) (defining Market on Open, Limit on Open, Opening

Market participants would likely want to know about any special opening, reopening, or closing processes, and after-hours trading procedures, employed by an NMS Stock ATS. In particular, the Commission preliminarily believes that market participants would want to know which, if any, order types participate in an NMS Stock ATS's opening, reopening, and/or closing processes, and after-hours trading. The Commission preliminarily believes that such information would help market participants assess whether participating in an NMS Stock ATS's opening, reopening, or closing processes, or after-hours trading on the NMS Stock ATS, would help accomplish their investing or trading objectives and thus, cause them to route orders to the NMS Stock ATS.

The disclosures required under Part IV, Item 9 of proposed Form ATS-N are also designed to help the Commission to better oversee NMS Stock ATSs and alert the Commission about any potential regulatory issues arising from an NMS Stock ATS's opening, reopening, or closing processes, or after-hours trading procedures. For example, under Rule 611(b)(3) of Regulation NMS,<sup>483</sup> single-priced opening and closing transactions are excepted from the Order Protection Rule under Rule 611(a) of Regulation NMS.<sup>484</sup> The Commission preliminarily believes the disclosures required under Part IV, Item 9 of proposed Form ATS-N would help the Commission analyze whether the opening, reopening, and/or closing processes of an NMS Stock

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Imbalance Only, and Market Hours order types); The Nasdaq Stock Market LLC Rule 4754(a) (defining Market on Close, Limit on Close, and Imbalance Only order types); BATS Exchange Rule 11.23(a) (defining Eligible Auction, Market-on-Open, Limit-on-Open, Late-Limit-on-Open, Market-on-Close, Limit-on-Close, and Late Limit-on-Close order types).

<sup>483</sup> See 17 CFR 242.611(b)(3).

<sup>484</sup> See 17 CFR 242.611(a).

ATS, and after-hours trading procedures, are consistent with the Exchange Act and the rules and regulations thereunder.

Request for Comment

412. Do you believe the Commission should require the disclosure of the information on Part IV, Item 9 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
413. Do you believe Part IV, Item 9 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS regarding its opening, reopening, or closing processes, if any, and any after-hours trading procedures? Please explain.
414. Do you believe there is other information that market participants might find relevant or useful regarding the opening or reopening processes, closing process, or after-hours trading procedures on the NMS Stock ATS? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
415. Is it sufficiently clear what information would be required by Part IV, Item 9 of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
416. Do you believe there is any information that would be required by Part IV, Item 9 of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.

417. Do you believe the information that would be required by Part IV, Item 9 of proposed Form ATS-N would be useful to market participants when deciding whether to trade on the NMS Stock ATS and would assist them in devising appropriate trading strategies to help accomplish their investing or trading objectives? Why or why not? Please support your arguments.
418. What are the potential costs and benefits of disclosing the information required by Part IV, Item 9 of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 9 of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.
419. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 9 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 9?

#### **J. Outbound Routing**

Part IV, Item 10(a) of Proposed Form ATS-N would require an NMS Stock ATS to describe the circumstances under which orders or other trading interest are routed from the NMS Stock ATS to another trading center, including whether outbound routing occurs at the affirmative instruction of the subscriber or at the discretion of the broker-dealer operator, and the means by which routing is performed (e.g., a third party or order management system or a SOR (or similar functionality) or algorithm of the broker-dealer operator or any of its affiliates). If the means by which orders or other trading interest are routed from the NMS Stock ATS are not the

same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences under Part IV, Item 10(b) of proposed Form ATS-N.

Based on Commission experience, some NMS Stock ATSs, by way of their broker-dealer operator, provide outbound routing services whereby a subscriber's order or trading interest could be routed to another trading center.<sup>485</sup> Orders and trading interest could be routed to other trading centers under a variety of circumstances. For instance, a subscriber could instruct the NMS Stock ATS to route its orders to another trading center if it is not immediately executed on the NMS Stock ATS upon entry. Also, a subscriber could enter an order on the NMS Stock ATS that rests as an open order on the NMS Stock ATS and is concurrently routed to another trading center for potential execution. If the order is executed at the away trading center, the NMS Stock ATS would cancel the order resting as an open order on the NMS Stock ATS. If the order is executed on the NMS Stock ATS, the order that was routed to the away market would be canceled.

The descriptions in response to Part IV, Item 10 of proposed Form ATS-N would be required to include who determines routing destinations, whether the subscriber, the broker-dealer operator, or both. This information is meant to illuminate when subscribers would have control over potential routing destinations and when the broker-dealer operator would have discretion to route away. The Commission preliminarily believes that subscribers would find it useful to be aware of any instance in which the broker-dealer operator has discretion to route

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<sup>485</sup> "Trading center" under Regulation NMS is defined as "a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent." 17 CFR 242.600(b)(78).

trading interest so that a subscriber could better protect its interests and monitor any such routing. Item 10 of proposed Form ATS-N would also require a description of the means by which the routing is performed. Examples of the means of outbound routing could include a third-party router, an order management system or SOR (or similar functionality) or algorithm of the broker-dealer operator or any of its affiliates, or any other functionality used to outbound route trading interest.

The Commission preliminarily believes that it is important for subscribers and potential subscribers to know at whose discretion any outbound routing occurs and who would be performing the routing. The Commission preliminarily believes that such disclosures concerning outbound routing would provide subscribers and potential subscribers with the ability to gauge how their orders would be handled if they are not executed on the NMS Stock ATS. Subscribers and potential subscribers might, for example, have concerns about the leakage of confidential trading information when their orders are routed to other trading centers. Part IV, Item 10 of proposed Form ATS-N is designed to provide subscribers and potential subscribers with relevant information to evaluate the potential for leakage of their confidential trading information. In addition, subscribers and potential subscribers could have concerns about the treatment of their confidential trading information should their orders be routed by a third party or the SOR (or similar functionality) or algorithm of the broker-dealer operator. Overall, the Commission preliminarily believes that information about routing would likely be useful to market participants when deciding whether to subscribe or otherwise submit orders to an NMS Stock ATS that might be eligible for routing.

The Commission also preliminarily believes that the disclosures required by Part IV, Item 10 of proposed Form ATS-N would aid it in evaluating whether an NMS Stock ATS is in

compliance with Rule 301(b)(10) of Regulation ATS.<sup>486</sup> The Commission could use the disclosures required under Item 10 of proposed Form ATS-N to evaluate whether there are any risks to the confidentiality of trading information on an NMS Stock ATS due to the outbound routing functionality being used. These disclosures would provide the Commission with insight into what trading information may be visible to the entity performing the NMS Stock ATS's outbound routing functions, such as a third party or the broker-dealer operator's SOR (or similar functionality) or algorithm.

Request for Comment

420. Do you believe the Commission should require the disclosure of the information on Part IV, Item 10 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
421. Do you believe Part IV, Item 10 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS regarding the circumstances under which orders or other trading interest are routed from the NMS Stock ATS to another trading center? Please explain.
422. Is it sufficiently clear what information would be required by Part IV, Item 10 of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
423. What mechanisms are available for NMS Stock ATSS to perform outbound routing? Do you believe there is any additional information that the Commission

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<sup>486</sup> See 17 CFR 242.301(b)(10).

- should require NMS Stock ATSs to disclose with regard to outbound routing? If so, explain what information and why. Please support your arguments.
424. Do you believe there is any information that would be required by Part IV, Item 10 of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.
425. Do you believe that the disclosures required under Part IV, Item 10 of proposed Form ATS-N would provide market participants with relevant information to evaluate the potential for leakage of their confidential trading information? Why or why not? Please be specific.
426. Do you believe transparency in how an NMS Stock ATS routes orders to other trading centers is useful to market participants when deciding whether to trade on the NMS Stock ATS and would assist them in devising appropriate trading strategies to help accomplish their investing or trading objectives? Why or why not?
427. Do you believe there is other information that market participants might find relevant or useful regarding the circumstances under which orders or other trading interest are routed from the NMS Stock ATS to another trading center? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
428. What are the potential costs and benefits of disclosing the information required by Part IV, Item 10 of proposed Form ATS-N? Would the proposed disclosures in

Part IV, Item 10 of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.

429. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 10 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 10?

#### **K. Market Data**

Part IV, Item 11 of proposed Form ATS-N would require an NMS Stock ATS to disclose its sources and use of market data. Part IV, Item 11(a) of proposed Form ATS-N would require a description of the market data used by the NMS Stock ATS and the source of that market data (e.g., market data feeds disseminated by the consolidated data processor (“SIP”) and market data feeds disseminated directly by an exchange or other trading center or third-party vendor of market data). Part IV, Item 11(b) of proposed Form ATS-N would require the NMS Stock ATS to describe the specific purpose for which the market data is used by the NMS Stock ATS, including how market data is used to determine the NBBO, protected quotes, pricing of orders and executions, and routing destinations. For instance, an NMS Stock ATS can elect to use market data feeds for purposes of complying with the trade through rule of Rule 611 of Regulation NMS<sup>487</sup> and for pricing executions on the NMS Stock ATS that are derived from prices on other trading centers, such as an execution at the mid-point of the NBBO. An NMS

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<sup>487</sup> See 17 CFR 242.611(a).

Stock ATS also might use data feeds to determine the prices available at other trading centers for purposes of routing orders or other trading interest.

The Commission preliminarily believes that market participants would likely find it useful to know the source and specific purpose for which market data is used by an NMS Stock ATS. For instance, the market data received by an NMS Stock ATS might affect the price at which orders are executed on the NMS Stock ATS.<sup>488</sup> In addition, because of the latency differences between the SIP and the direct data feeds of the exchanges,<sup>489</sup> the source of an NMS Stock ATS's market data could impact the price received by a market participant, depending on the ATS's source of the market data. Accordingly, the Commission preliminarily believes that Part IV, Item 11 of proposed Form ATS-N would provide market participants with information to assist them in developing optimal trading strategies to account for any potential latency differences between market data feeds. Furthermore, the Commission preliminarily believes that these disclosures would assist subscribers to understand the procedures employed by the NMS Stock ATS for complying with Regulation NMS, including an understanding about how their orders might be routed by the NMS Stock ATS. The Commission also preliminarily believes that the disclosures required under Item 11 could help the Commission in understanding how

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<sup>488</sup> See supra Section VIII.385 (explaining how NMS Stock ATSS might use the NBBO to set execution prices). See also Morgan Stanley letter, supra note 197, (stating it received customer questions specific to the use of direct market data feeds by the dark pool's servers and algorithmic strategies).

<sup>489</sup> See 2010 Equity Market Structure Release, supra note 124, at 3611 ("Given the extra step required for SROs to transmit market data to plan processors, and for plan processors to consolidate the information and distribute it the public, the information in the individual data feeds of exchanges and ECNs generally reaches market participants faster than the same information in the consolidated data feeds.").

market data is used for purposes of monitoring developments in market structure.

Request for Comment

430. Do you believe the Commission should require the disclosure of the information on Part IV, Item 11 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
431. Do you believe Part IV, Item 11 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS regarding the sources and use of market data? Please explain.
432. Is it sufficiently clear what information would be required by Part IV, Item 11 of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
433. Do you believe there is other information that market participants might find relevant or useful regarding the sources and use of market data? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
434. Do you believe there is any information that would be required by Part IV, Item 11 of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.
435. Are there any other applications for which NMS Stock ATSs use market data that the Commission should specifically identify and/or discuss under Part IV, Item 11 of Proposed Form ATS-N?

436. Do you believe that transparency regarding what market data an NMS Stock ATS uses and how the NMS Stock ATS uses that market data is useful to market participants when deciding whether to trade on the NMS Stock ATS and would assist them in devising appropriate trading strategies to help accomplish their investing or trading objectives? Why or why not?
437. Do you believe that the disclosures required under Part IV, Item 11 of Proposed Form ATS-N would assist the Commission to understand the procedures employed by an NMS Stock ATS for complying with Regulation NMS and to understand how orders are priced, handled, and routed by the NMS Stock ATS? Why or why not?
438. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 11 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 11?
439. What are the potential costs and benefits of disclosing the information required by Part IV, Item 11 of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 11 of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.

#### **L. Fees**

Part IV, Item 12 of proposed Form ATS-N would require the NMS Stock ATS to disclose and describe its fee and rebate structure. Part IV, Item 12(a) of proposed Form ATS-N would

require an NMS Stock ATS to describe any fees, rebates, or other charges of the NMS Stock ATS (e.g., connectivity fees, subscription fees, execution fees, volume discounts) and provide the range (e.g., high and low) of such fees, rebates, or other charges. If the fees, rebates, or other charges of the NMS Stock ATS are not the same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences under Part IV, Item 12(b) of proposed Form ATS-N.

The Commission preliminarily believes that by requiring a description of an NMS Stock ATS's fees, rebates, and other charges, market participants would be able to review and evaluate the fee structure of each NMS Stock ATS. If an NMS Stock ATS has a recognized fee structure, such as a maker-taker pricing model,<sup>490</sup> that information would be required to be disclosed under Part IV, Item 12 of proposed Form ATS-N. The Commission preliminarily believes these disclosures would allow market participants to analyze the fee structures across NMS Stock ATSs in an expedited manner and decide which ATS offers them the best pricing according to the characteristics of their order flow, the type of participant they are (if relevant), or any other aspects of an ATS's fee structure that serves to provide incentives or disincentives for specific market participants or trading behaviors. For instance, an institutional subscriber that commonly adds non-marketable, resting orders that offer liquidity may choose to subscribe to an ATS that rewards liquidity-providing orders with rebates. The types of fees charged for services also could influence whether a market participant subscribes to, or the extent to which it participates on, an NMS Stock ATS. For instance, an NMS Stock ATS with relatively higher connectivity

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<sup>490</sup> Under the maker-taker pricing model, non-marketable, resting orders that offer (make) liquidity at a particular price receive a liquidity rebate if they are executed, while incoming orders that execute against (take) the liquidity of resting orders are charged an access fee. See 2010 Equity Market Structure Release, supra note 124, at 3598-3599.

fees and relatively lower execution fees may not be as attractive to a market participant that only intends to send the NMS Stock ATS a small amount of trading interest.

The Commission also is proposing to require that NMS Stock ATSs describe any differences in their fees, rebates, or other charges among differing types of subscribers or other persons. The Commission preliminarily believes that this information would further illuminate the types of subscribers and/or trading interest that the NMS Stock ATS may be trying to attract.<sup>491</sup> This information would allow market participants to observe whether an NMS Stock ATS is offering more preferential treatment to other market participants and, therefore, aid market participants in deciding where to route their trading interest accordingly.<sup>492</sup>

Part IV, Item 12 of proposed Form ATS-N also would require that the NMS Stock ATS provide the range (e.g., high and low) of such fees, rebates, or other charges. For these disclosures, the types of fees should be categorized in the same manner as the NMS Stock ATS divides fees internally or on its fee schedule. For example, if an NMS Stock ATS provides rebates for liquidity added onto the ATS, then the range for such rebates would be required by this item. If these rebates are further divided into differing rebate amounts depending on order types used, then the range of such rebates for each order type would also need to be disclosed on proposed Form ATS-N.

Item 12, however, does not require NMS Stock ATSs to disclose a complete schedule of their fees. In some cases, the fee schedules employed by NMS Stock ATSs are highly bespoke,

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<sup>491</sup> See Bloomberg Tradebook letter, *supra* note 190 and accompanying text (recommending that the Commission ask ATSs to complete a questionnaire including questions relating to any special fees or rebates which lead to a preference of one order over another).

<sup>492</sup> But see *supra* notes 92-95 and 425-427 and accompanying text (discussing the fair access requirements of Regulation ATS).

and it may not be practical or desirable to require an NMS Stock ATS to disclose the fee schedule applicable to each subscriber to the NMS Stock ATS. The Commission, therefore, is proposing that the NMS Stock ATS disclose only the range of fees for each service. These disclosures are designed to give market participants an awareness of the fees charged by the NMS Stock ATS and allow market participants to understand and compare fees across NMS Stock ATSs, which could reduce the search costs of market participants in deciding where to send their orders and trading interest. The Commission preliminarily believes that the disclosures required by Part IV, Item 12 of proposed Form ATS-N would also assist the Commission in better understanding the fee structures of NMS Stock ATSs and trends in the market as part of the Commission's overall review of market structure.

Request for Comment

440. Do you believe the Commission should require the disclosure of the information on Part IV, Item 12 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
441. Do you believe Part IV, Item 12 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS regarding its fee and rebate structure? Please explain.
442. Is it sufficiently clear what information would be required by Part IV, Item 12 of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
443. Do you believe the Commission should require NMS Stock ATSs to publicly disclose their fees, charges, and rebates on proposed Form ATS-N? Why or why not?

444. Do you believe the Commission should require NMS Stock ATSS to disclose their complete fee schedules? Are there other ways that NMS Stock ATSS earn revenue about which the Commission should require disclosure?
445. Do you believe there is other information that market participants might find relevant or useful regarding fees, rebates and other charges? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
446. Do you believe there is any information that would be required by Part IV, Item 12 of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.
447. Do you believe that the information required by Part IV, Item 12 of proposed Form ATS-N would assist market participants and the Commission in comparing fees across NMS Stock ATSS? Why or why not? Please support your arguments.
448. Do you believe that the information required by Part IV, Item 12 of proposed Form ATS-N would allow the Commission to gather further information and analyze trends in the market, including how the prevalence of different fee structures may impact different categories of market participants? Would this information assist the Commission in evaluating the potential incentives and disincentives created by different fee structures in the market for NMS stocks? Why or why not? Please support your arguments.

449. What are the potential costs and benefits of disclosing the information required by Part IV, Item 12 of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 12 of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.

450. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 12 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 12?

#### **M. Trade Reporting, Clearance and Settlement**

Part IV, Item 13 would require an NMS Stock ATS to describe its arrangements or procedures for trade reporting, clearance, and settlement of transactions. Part IV, Item 13(a) of proposed Form ATS-N would require an NMS Stock ATS to describe any arrangements or procedures for reporting transactions on the NMS Stock ATS and if the trade reporting procedures are not the same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences. Part IV, Item 13(b) of proposed Form ATS-N would require an NMS Stock ATS to describe any arrangements or procedures undertaken by the NMS Stock ATS to facilitate the clearance and settlement of transactions on the NMS Stock ATS. If the clearance and settlement procedures are not the same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences. The Commission notes that Item 13 of proposed Form ATS-N would solicit similar information that is solicited pursuant to Exhibit F, subsection (d) of Form ATS, which currently requires ATSs to provide their

procedures governing execution, reporting, clearance, and settlement of transactions effected through the ATS.<sup>493</sup>

Trade reporting furthers the transparent, efficient, and fair operation of the securities markets.<sup>494</sup> For example, among other requirements, a broker-dealer operator of an NMS Stock ATS that is a member of FINRA has trade reporting obligations to FINRA under FINRA Rule 4552 and FINRA Rule 6730. The Commission preliminarily believes the proposed disclosure of the trade reporting procedures of an NMS Stock ATS under Part IV, Item 13(a) of proposed Form ATS-N would also allow the Commission and the NMS Stock ATS's SRO to more easily review the compliance of the NMS Stock ATS with its applicable trade reporting obligations. The Commission also preliminarily believes market participants may also find the disclosure of these procedures useful to understanding how their trade information is reported.

Part IV, Item 13(b) of proposed Form ATS-N would require that an NMS Stock ATS describe any arrangements or procedures undertaken by the NMS Stock ATS to facilitate the clearance and settlement of transactions on the NMS Stock ATS. The Commission has previously stated that the integrity of the trading markets depends on the prompt and accurate

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<sup>493</sup> In contrast to current Form ATS, Form ATS-N further would require that an NMS Stock ATS describe any differences in the manner in which its trade reporting, clearance, and settlement procedures are applied among subscribers and other persons. Also, Exhibit F, subsection (d) of Form ATS requires ATSS to provide the procedures governing execution in the same section as reporting and clearance and settlement procedures, whereas Form ATS-N would require information on execution procedures under a separate item, Part IV, Item 7.

<sup>494</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70887 (stating the market-wide transaction and quotation reporting plans operated by the registered national securities exchanges are responsible for the transparent, efficient, and fair operations of the securities markets).

clearance and settlement of securities transactions.<sup>495</sup> For example, the description of procedures required by Item 13(b) of proposed Form ATS-N could include the process through which an NMS Stock ATS clears a trade (e.g., whether the NMS Stock ATS becomes a counterparty to a transaction, interposing itself between two counterparties to a transaction, or whether the NMS Stock ATS submits trades to a registered clearing agency for clearing) and any requirements an NMS Stock ATS places on its subscribers, or other persons whose orders are routed to an NMS Stock ATS, to have clearance and settlement systems and/or arrangements with a clearing firm. The Commission preliminarily believes market participants would likely find the disclosures required by Item 13(b) to be useful in understanding the measures undertaken by an NMS Stock ATS to facilitate clearance and settlement of subscriber orders on the NMS Stock ATS and allow them to more easily compare the clearance arrangements required across NMS Stock ATSs as part of deciding where to route their trading interest. The Commission preliminarily believes that the disclosures required by Part IV, Item 13 of proposed Form ATS-N may assist the Commission in better understanding the trade reporting, clearance and settlement procedures of NMS Stock ATSs and trends in the market as part of the Commission's overall review of market structure.

Request for Comment

451. Do you believe the Commission should require the disclosure of the information on Part IV, Item 13 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.

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<sup>495</sup> See id. at 70897.

452. Do you believe Part IV, Item 13 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS regarding its arrangements or procedures for trade reporting, clearance, and settlement of transactions? Please explain.
453. Do you believe there is other information that market participants might find relevant or useful regarding procedures for trade reporting, clearance, and settlement of transactions on the NMS Stock ATSs? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
454. Is it sufficiently clear what information would be required by Part IV, Item 13 of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific
455. Do you believe there is any information that would be required by Part IV, Item 13 of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.
456. Do you believe that the information required by Part IV, Item 13 of proposed Form ATS-N will assist market participants in the manner describe above? Why or why not? Please support your arguments.
457. What are the potential costs and benefits of disclosing the information required by Part IV, Item 13 of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 13 of proposed Form ATS-N require an NMS Stock ATS to reveal

too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.

458. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 13 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 13?

#### **N. Order Display and Execution Access**

Part IV, Item 14 of proposed Form ATS-N would require an NMS Stock ATS to provide the following information if the NMS Stock ATS displays orders in an NMS stock to any person other than employees of the NMS Stock ATS and executed 5% or more of the average daily trading volume in that NMS stock as reported by an effective transaction reporting plan for four of the preceding six calendar months: (a) the ticker symbol for each such NMS stock displayed for each of the last 6 calendar months; (b) the manner in which the NMS Stock ATS displays such orders on a national securities exchange or through a national securities association; and (c) how the NMS Stock ATS provides access to such orders displayed in the national market system equivalent to the access to other orders displayed on that exchange or association.<sup>496</sup>

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<sup>496</sup> In response to Part IV, Item 14 of proposed Form ATS-N, an NMS Stock ATS filing a Form ATS-N would indicate “not applicable” if the NMS Stock ATS had not triggered the volume thresholds under Rule 301(b)(3)(i) of Regulation ATS before commencing operations pursuant to an effective Form ATS-N. If an NMS Stock ATS triggers the Rule 301(b)(3)(i) thresholds after commencing operations pursuant to an effective Form ATS-N, the Commission generally would consider this to be a material change to the operations of the NMS Stock ATS (assuming it is not already complying with the display and access requirements of Rule 301(b)(3)), and the NMS Stock ATS would be required to file a Form ATS-N Amendment pursuant to proposed Rule 304(a)(2)(i)(A). In the

The information elicited in Part IV, Item 14 relates to an NMS Stock ATS's obligations under current Rule 301(b)(3) of Regulation ATS, which applies if an ATS displays a subscriber order in an NMS stock to any person other than ATS employees, and during at least 4 of the preceding 6 calendar months, executed 5% or more of the average daily trading volume in that NMS Stock as reported by an effective transaction reporting plan. Rule 301(b)(3)(ii) and (iii) requires qualifying ATSS to report their highest bid and lowest offer for the relevant NMS stock for inclusion in the quotation data made available by the national securities exchange or national securities association to which it reports and provide equivalent access to effect a transaction with other orders displayed on the exchange or by the association.<sup>497</sup> Under the current

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case where an NMS Stock ATS has voluntarily chosen to comply with the display and access requirements of Rule 301(b)(3)(ii) and (iii) before crossing the relevant thresholds, the NMS Stock ATS would nevertheless have to file a Form ATS-N Amendment upon surpassing the thresholds within 30 days after the end of the calendar quarter pursuant to proposed Rule 304(a)(2)(i)(B).

<sup>497</sup> Specifically, Rule 301(b)(3)(ii) and (iii) of Regulation ATS require the following from ATSS that meet the display and volume thresholds of Rule 301(b)(1):

(ii) Such alternative trading system shall provide to a national securities exchange or national securities association the prices and sizes of the orders at the highest buy price and the lowest sell price for such NMS stock, displayed to more than one person in the alternative trading system, for inclusion in the quotation data made available by the national securities exchange or national securities association to vendors pursuant to 17 CFR 242.602.

(iii) With respect to any order displayed pursuant to paragraph (b)(3)(ii) of this section, an alternative trading system shall provide to any broker-dealer that has access to the national securities exchange or national securities association to which the alternative trading system provides the prices and sizes of displayed orders pursuant to paragraph (b)(3)(ii) of this section, the ability to effect a transaction with such orders that is:

(A) Equivalent to the ability of such broker-dealer to effect a transaction with other orders displayed on the exchange or by the association; and

regulatory regime for ATSS, there is no mechanism under which an ATS must notify the Commission, its SRO, or market participants after it has triggered those requirements.<sup>498</sup>

The information required by Part IV, Item 14 of proposed Form ATS-N is designed to elicit information about how the NMS Stock ATS complies with the requirements of Rule 301(b)(3) of Regulation ATS when applicable. The Commission preliminarily believes that the disclosure of the information required by Item 14 of proposed Form ATS-N would facilitate the Commission's oversight of NMS Stock ATSS and their compliance with Rule 301(b)(3) and help the Commission discover a potential violation of the federal securities laws and rules or regulations thereunder in a more expeditious manner than if the disclosures were not required. In part, because the thresholds required for display and access are counted for each NMS stock individually, an NMS Stock ATS would be required to disclose the ticker symbol for the relevant NMS stock to aid the Commission in evaluating its compliance. The Commission also preliminarily believes that these disclosures would help ensure that market participants and the Commission are aware when an NMS Stock ATS has become a significant source of liquidity in an NMS stock. Further, the Commission preliminarily believes that market participants would

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(B) At the price of the highest priced buy order or lowest priced sell order displayed for the lesser of the cumulative size of such priced orders entered therein at such price, or the size of the execution sought by such broker-dealer.

<sup>498</sup> In contrast, an ATS that triggers the "fair access" requirements under Rule 301(b)(5), see supra notes 92-95 and 424-427 and accompanying text, is required to attach Exhibit C to Form ATS-R, which is filed with the Commission, but not publicly available. Exhibit C of Form ATS-R requires an ATS that triggered the fair access requirements to: (1) provide a list of all persons granted, denied, or limited access to the ATS during the period covered by the ATS-R and (2) designate for each person (a) whether they were granted, denied, or limited access, (b) the date the ATS took such action, (c) the effective date of such action, and (d) the nature of any denial or limitation of access. See supra note 451.

find the information disclosed in this item useful to understand how they can access applicable quotations.

Request for Comment

459. Do you believe the Commission should require the disclosure of the information on Part IV, Item 14 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
460. Do you believe Part IV, Item 14 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS regarding the NMS Stock ATS's obligations under current Rule 301(b)(3) of Regulation ATS? Please explain.
461. Do you believe there is other information that market participants might find relevant or useful regarding the NMS Stock ATS's obligations under current Rule 301(b)(3) of Regulation ATS? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
462. Is it sufficiently clear what information would be required by Part IV, Item 14 of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
463. Do you believe there is any information that would be required by Part IV, Item 14 of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.

464. Do you believe that the information required by Part IV, Item 14 of proposed Form ATS-N will assist market participants in accessing applicable quotations and ensuring they receive equivalent access on the NMS Stock ATS? Why or why not? Please support your arguments.
465. Do you believe that the imposition of the requirements of Rule 301(b)(3) on an NMS Stock ATS crossing the relevant volume thresholds of Rule 301(b)(3)(i) and meeting the display requirement of the rule, should constitute a material change in the operations of the NMS Stock ATS such that it should be reported to the Commission in advance? Why or why not?
466. What are the potential costs and benefits of disclosing the information required by Part IV, Item 14 of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 14 of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.
467. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 14 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 14?

In 2009, the Commission published a proposal to address certain practices with respect to undisplayed liquidity, which is trading interest that is available for execution at a trading center,

but is not included in the consolidated quotation data that is widely disseminated to the public.<sup>499</sup> Among other things, the Commission proposed amending Rule 301(b)(3) of Regulation ATS to lower the trading volume threshold that triggers public display obligations for ATSs from 5% or more of the aggregate average daily share volume for an NMS stock as reported by an effective transaction reporting plan to 0.25% or more of the aggregate average daily share volume for an NMS stock as reported by an effective transaction reporting plan.<sup>500</sup> The Commission also proposed to change the definition of “bid” or “offer” in Regulation NMS to clarify that the public quoting requirements apply to actionable indications of interest privately transmitted by dark pools to selected market participants.<sup>501</sup>

#### Request for Comment

468. Do you believe that the Commission should lower the 5% trading volume threshold in Rule 301(b)(3) of Regulation ATS that triggers the public display requirement for ATSs? Why or why not? If so, what is the appropriate threshold level? Please support your arguments.
469. Do you believe that the Commission should define actionable indications of interest in the definition of “bid” and “offer” in Regulation NMS? Why or why not? Please support your arguments.

#### O. Fair Access

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<sup>499</sup> See generally Regulation of Non-Public Trading Interest, *supra* note 123.

<sup>500</sup> See *id.* at 61216.

<sup>501</sup> See *id.*

Part IV, Item 15 of proposed Form ATS-N would require an NMS Stock ATS to provide the following information if the NMS Stock ATS executes 5% or more of the average daily trading volume in an NMS stock as reported by an effective transaction reporting plan for four of the preceding six calendar months: (a) the ticker symbol for each NMS stock for each of the last 6 calendar months; and (b) a description of the written standards for granting access to trading on the NMS Stock ATS.<sup>502</sup> As explained above,<sup>503</sup> Rule 301(b)(5)(ii)(A) of Regulation ATS requires an ATS to establish written standards for granting access to trading on its system when it crosses the fair access thresholds of Rule 301(b)(5)(i) and does not meet the exception set forth in Rule 301(b)(5)(iii). If an ATS crosses the fair access thresholds, Rule 301(b)(5)(ii)(B) requires the ATS to “not unreasonably prohibit or limit any person in respect to access to services offered by such alternative trading system by applying the [written] standards . . . in an unfair or discriminatory manner.”<sup>504</sup>

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<sup>502</sup> In response to Part IV, Item 15 of proposed Form ATS-N, an NMS Stock ATS filing a Form ATS-N would indicate “not applicable” if the NMS Stock ATS had not triggered the volume thresholds under Rule 301(b)(5)(i) of Regulation ATS before commencing operations pursuant to an effective Form ATS-N. If an NMS Stock ATS triggers the Rule 301(b)(5)(i) thresholds after commencing operations pursuant to an effective Form ATS-N, the Commission would generally consider this to be a material change to the operations of the NMS Stock ATS (assuming it is not already complying with the fair access requirements of Rule 301(b)(5)), and the NMS Stock ATS would be required to file a Form ATS-N Amendment pursuant to proposed Rule 304(a)(2)(i)(A). In the case where an NMS Stock ATS has voluntarily chosen to comply with the fair access requirements of Rule 301(b)(5)(ii) before crossing the relevant thresholds, the NMS Stock ATS would nevertheless have to file a Form ATS-N Amendment upon surpassing the thresholds within 30 days after the end of the calendar quarter pursuant to Rule proposed 304(a)(2)(i)(B).

<sup>503</sup> See supra notes 92-95 and accompanying text.

<sup>504</sup> See 17 CFR 242.301(b)(5)(ii)(B).

The Commission preliminarily believes that the disclosure of the information requested by Part IV, Item 15 of proposed Form ATS-N would facilitate the Commission's oversight of NMS Stock ATSs and their compliance with Rule 301(b)(5). Because the volume thresholds required for fair access are counted for each NMS stock individually, an NMS Stock ATS would be required to disclose the ticker symbol for the relevant NMS stock to aid the Commission in evaluating the NMS Stock ATS's compliance. The Commission also preliminarily believes that it is important for market participants to be aware of whether an NMS Stock ATS is a significant source of liquidity for an NMS stocks and therefore, must provide fair access. Although Exhibit C of Form ATS-R requires an ATS to notify the Commission when it has crossed a fair access threshold in a particular calendar quarter,<sup>505</sup> there is currently no requirement that an ATS must notify the public when it has done so. The Commission preliminarily believes that having such information publicly available will help market participants better evaluate trading opportunities and where to route orders in order to reach their trading and/or investment objectives. The Commission preliminarily believes that the disclosures that would be required by Item 15 would help the Commission discover a potential violation of the federal securities laws and rules or regulations thereunder in a more expeditious manner than if the disclosures were not required.

Request for Comment

470. Do you believe the Commission should require the disclosure of the information on Part IV, Item 15 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.

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<sup>505</sup> See supra note 451.

471. Do you believe Part IV, Item 15 of proposed Form ATS-N captures the information that is most relevant to understanding the operations of the NMS Stock ATS regarding the written standards for granting access to trading on its system when it crosses the fair access thresholds of Rule 301(b)(5)(i) (and does not meet the exception set forth in Rule 301(b)(5)(iii))? Please explain.
472. Do you believe there is other information that market participants might find relevant or useful regarding the written standards for granting access to trading on its system when it crosses the fair access thresholds of Rule 301(b)(5)(i) (and does not meet the exception set forth in Rule 301(b)(5)(iii))? If so, describe such information and explain whether, and if so why, such information should be required to be provided under proposed Form ATS-N. Please support your arguments.
473. Do you believe there is any information that would be required by Part IV, Item 15 of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.
474. Is it sufficiently clear what information would be required by Part IV, Item 15 of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
475. Do you believe that the disclosures under Part IV, Item 15 of proposed Form ATS-N would help market participants better evaluate trading opportunities and where to route orders in order to reach their investment objectives? Why or why not? Please support your arguments.

476. Do you believe that the imposition of the requirements of Rule 301(b)(5) on an NMS Stock ATS crossing the relevant volume thresholds of Rule 301(b)(5)(i) should constitute a material change in the operations of the NMS Stock ATS such that it should be reported to the Commission in advance? Why or why not?
477. What are the potential costs and benefits of disclosing the information required by Part IV, Item 15 of proposed Form ATS-N? Would the proposed disclosures in Part IV, Item 15 of proposed Form ATS-N require an NMS Stock ATS to reveal too much (or not enough) information about its structure and operations? Why or why not? Please support your arguments.
478. Do you believe there are other ways to obtain the same information as would be required from NMS Stock ATSs by Part IV, Item 15 of proposed Form ATS-N other than through disclosure on proposed Form ATS-N? If so, how else could this information be obtained and would such alternative means be preferable to the proposed disclosures in Part IV, Item 15?

**P. Market Quality Statistics Published or Provided by the NMS Stock ATS to Subscribers**

Part IV, Item 16 of proposed Form ATS-N would require an NMS Stock ATS to explain and provide certain aggregate platform-wide market quality statistics that it publishes or provides to one or more subscribers regarding the NMS Stock ATS.<sup>506</sup> Under Item 16, if the NMS Stock ATS publishes or otherwise provides to one or more subscribers aggregate platform-wide order flow and execution statistics of the NMS Stock ATS that are not otherwise required disclosures

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<sup>506</sup> An NMS Stock ATS would only be required to provide order flow and execution statistics that are aggregated across the ATS as a whole, not subscriber-specific order flow and execution statistics.

under Exchange Act Rule 605 of Regulation NMS, it would be required to: (i) list and describe the categories of the aggregate platform-wide order flow and execution statistics published or provided; (ii) describe the metrics and methodology used to calculate the aggregate platform-wide order flow and execution statistics; and (iii) attach as Exhibit 5 the most recent disclosure of the aggregate platform-wide order flow and execution statistics published or provided to one or more subscribers for each category or metric as of the end of the calendar quarter. An NMS Stock ATS would not be required to develop or publish any new statistics for purposes of making this disclosure; it would only be required to make the disclosures for statistics it already otherwise collects and publishes or provides to one or more subscribers to the NMS Stock ATS.

The Commission preliminarily believes that some NMS Stock ATSS voluntarily publish or otherwise provide to subscribers aggregate platform-wide order flow and execution statistics that do not fall under the statistical information that is required to be disclosed under Exchange Act Rule 605,<sup>507</sup> which requires market centers, such as NMS Stock ATSS, to publish monthly reports of statistics on their order executions. To the extent an NMS Stock ATS publishes or provides such aggregate platform-wide statistics to one or more subscribers, Part IV, Items 16(a) and (b) of proposed Form ATS-N would require the NMS Stock ATS to list and describe the categories or metrics of the statistics it publishes or provides to subscribers and describe any criteria or methodology that the ATS uses to calculate those statistics, respectively. Item 16(c) would require the NMS Stock ATS to attach as Exhibit 5 the most recent disclosure of order flow and execution statistics published or provided for each category or metric as of the end of

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<sup>507</sup> 17 CFR 242.605.

the calendar quarter.<sup>508</sup> To comply with the requirements of Item 16(c), an NMS Stock ATS would file a Form ATS-N Amendment with an updated Exhibit 5 within 30 calendar days after the end of each calendar quarter.<sup>509</sup>

Under Part IV, Item 16, an NMS Stock ATS would be required to explain and provide any aggregate platform-wide order flow or execution statistic that is not otherwise a required disclosure under Exchange Act Rule 605 and published or provided to one or more subscribers by the NMS Stock ATS. An example of a type of statistic that would be a required disclosure under Item 16 would be statistics related to the percentage of midpoint executions on the NMS Stock ATS that the NMS Stock ATS publishes or otherwise provides to subscribers. The NMS Stock ATS would be required to list that category under Part IV, Item 16(a) and explain how the NMS Stock ATS calculates that statistic under Item 16(b). Within 30 calendar days after the end of each calendar quarter, the NMS Stock ATS would be required to attach an Exhibit 5 containing the most recent percentage it disseminated during the previous quarter. The Commission preliminarily believes that requiring the NMS Stock ATS to provide the statistic on Form ATS-N on a quarterly basis would allow market participants to obtain insight into the nature of trading on the NMS Stock ATS on a sufficiently frequent basis while minimizing the reporting burden for the NMS Stock ATS.

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<sup>508</sup> For instance, if an NMS Stock ATS publishes or provides a particular statistic on a daily basis, the NMS Stock ATS would include in Exhibit 5 the statistic that was published or provided to one or more subscribers on the last trading day of the calendar quarter (e.g., the statistic published or provided on June 30<sup>th</sup> or last trading day prior to June 30<sup>th</sup>). If an NMS Stock ATS publishes or provides a particular statistic weekly, the NMS Stock ATS would be required to include in Exhibit 5 the statistic that was published or provided to one or more subscribers at the end of the week prior to the end of the calendar quarter (e.g., the statistic published for the last full week of June).

<sup>509</sup> See proposed Rule 304(a)(2)(i)(B).

The Commission preliminarily believes that an NMS Stock ATS may choose to create and publish or provide to one or more subscribers information concerning order flow and execution quality for different reasons. For example, the NMS Stock ATS may have concluded that publication of certain statistics may highlight certain characteristics of the NMS Stock ATS that would attract certain order flow. Or a subscriber may have requested that the NMS Stock ATS provide certain aggregated information concerning order flow and execution quality that the subscriber needed to assess the ATS's operations. The Commission notes that certain performance metrics and statistics may be important factors for investors and subscribers in comparing and selecting an ATS that is most appropriate for their investment objectives.<sup>510</sup> Indeed, Exchange Act Rule 605 currently requires ATSS to provide quarterly public reports containing certain information concerning ATS executions. As such, to the extent that an NMS Stock ATS has made a determination to create and publish or provide to subscribers certain aggregate platform-wide order flow and execution quality statistics, the Commission preliminarily believes that others may also find such information useful when evaluating an NMS Stock ATS as a possible venue to which to route orders in order to accomplish their investing or trading objectives.

The Commission also solicits comment on whether other standardized statistical disclosures should be required from NMS Stock ATSS and the nature and extent of any such metrics or statistics that commenters believe should be disclosed.

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<sup>510</sup> See generally Tuttle: ATS Trading in NMS Stocks, supra note 126.

Request for Comment

479. Do you believe the Commission should require the disclosure of the information on Part IV, Item 16 of Form ATS-N? Why or why not? If so, what level of detail should be disclosed? Please be specific.
480. Do you believe that the statistics required on Part IV, Item 16 of Form ATS-N should be provided on a more or less frequent basis? Why or why not? If so, how often should the statistics be provided (e.g., on a daily, weekly, monthly, quarterly, or annual basis)? Please support your arguments.
481. Is it sufficiently clear what information would be required by Part IV, Item 16 of proposed Form ATS-N? Should the item be refined in any way? If so, how? Please be specific.
482. Do you believe that the disclosures under Part IV, Item 16 of proposed Form ATS-N would help market participants better evaluate trading opportunities and where to route orders in order to reach their investment objectives? Why or why not? Please support your arguments.
483. Do you believe that the Commission should require standardized public disclosures of performance metrics or statistics for each NMS Stock ATS? Why or why not? Please support your arguments. If so, what metrics or statistics should NMS Stock ATSS be required to disclose publicly? Please be specific.
484. What percentage of NMS Stock ATSS publish or provide market quality statistics not otherwise required under Exchange Act Rule 605? Please explain how you have calculated this number.

485. Do you believe that there are other statistics or data that an NMS Stock ATS should be required to provide on proposed Form ATS-N that would be useful to market participants that either subscribe to or are considering subscribing to the NMS Stock ATS? If so, please identify those metrics and explain how they would be useful to market participants. Please support your arguments.
486. Should the Commission require NMS Stock ATSs to disclose on Form ATS-N, statistics regarding the extent of trading by the broker-dealer operator and its affiliates on the NMS Stock ATS? Why or why not? If so, what statistics should be required to be disclosed? Please support your arguments. If you believe that an NMS Stock ATS should disclose statistics about the extent of its broker-dealer operator's and its affiliates' trading activity on the NMS Stock ATS, how often should these statistics be disclosed (e.g., on a weekly, monthly, quarterly, annual basis)?
487. Do you believe there is any information that would be required by Part IV, Item 16 of proposed Form ATS-N that an NMS Stock ATS should not be required to disclose due to concerns regarding confidentiality, business reasons, trade secrets, burden, or any other concerns? Why or why not? Please support your arguments.

The Commission also notes that some industry participants have previously requested public statistics about the quality of these markets. In the 2010 Equity Market Structure Release, the Commission solicited public comment about, among other things, market structure performance and order execution quality, and how transparency could be improved in these

areas.<sup>511</sup> For example, the Commission noted that an important objective of many dark pools is to offer institutional investors an efficient venue in which to trade in large size with minimized market impact,<sup>512</sup> and requested comment on the extent to which dark pools meet this objective of improving execution quality for the large orders of institutional investors.<sup>513</sup> In seeking comment on other tools to protect investor interests, the Commission also requested comment on Exchange Act Rules 605 and Exchange Act Rule 606.<sup>514</sup> Exchange Act Rule 606 requires broker-dealers to publish quarterly reports on their routing practices, including the venues to which they route orders for execution.<sup>515</sup> Specifically, the Commission asked about the currency of Exchange Act Rules 605 and 606 and whether the information provided on the reports was useful to investors and their brokers in assessing the quality of order execution and routing practices.<sup>516</sup>

In response, some commenters stated their concern about the lack of market quality information available to the public about ATNs and other trading centers. For example, one commenter expressed support for national securities exchanges and ATNs to disclose how often a functionality is used and more market quality statistics, such as quote-per-execution ratios, duration of quotes and number of times orders are routed out without getting filled so that investors and other market participants could better gauge execution quality.<sup>517</sup> Another

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<sup>511</sup> See Equity Market Structure Release, supra note 124 at 3602-3614. See also supra Section III.D (discussing certain comments received on the Equity Market Structure Release).

<sup>512</sup> See Equity Market Structure Release, supra note 124 at 3612.

<sup>513</sup> See id.

<sup>514</sup> 17 CFR 242.606.

<sup>515</sup> See 2010 Equity Market Structure Release, supra note 124, at 3605-3606.

<sup>516</sup> See id.

<sup>517</sup> Goldman Sachs letter, supra note 175, at 10.

commenter stated that “regulators should direct broker-dealers to provide public reports of order routing and execution quality metrics that are geared toward retail investors.”<sup>518</sup> This commenter also stated that “the Commission should direct broker-dealers to provide institutional clients with standardized execution venue statistical analysis reports” and noted its commitment “to working with other industry groups to develop consistent industry templates, which it believes will greatly enhance institutional investors’ ability to evaluate their brokers’ routing practices and the quality of execution provided by different venues.”<sup>519</sup> Another commenter stated its belief that publicly available order routing and execution quality statistics pursuant to Rules 605 and 606 do not provide information to measure broker-dealers’ and execution venues’ performance with respect to specific institutional investors and that the reports are not presented in a uniform manner that allows for easy comparison across different broker-dealers and venues.<sup>520</sup>

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<sup>518</sup> See SIFMA letter #2, supra note 175 at 12. For example, the commenter suggested including information on “ (i) percent of shares Improved, (ii) average price improvement, (iii) net Price Improvement per share, and (iv) effective/quoted spread ratio.”

<sup>519</sup> See SIFMA letter #2, supra note 175 at 13. The commenter gave examples of the types of information (per venue) that should be incorporated into these reports as: (i) percentage of orders executed, (ii) average number of shares ordered and executed, (iii) fill rates—overall, taken, added, and routed, and (iv) percentage executed displayed and undisplayed.

<sup>520</sup> See letter from Dorothy M. Donohue, Deputy General Counsel, Investment Company Institute; Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association; and Randy Snook, Executive Vice President, Securities Industry and Financial Markets Association, dated October 23, 2014, at 2.

This commenter also provided a template for disclosure of order routing and execution quality information that institutional investors could request from their broker-dealers, which included, among other things: the number of total shares routed as actionable IOIs; the percent of shares routed to the venue by the broker that resulted in executions at that venue); the average length of time (measured in milliseconds) that orders (other than IOCs) were posted to a venue before being filled or cancelled; the average size, by number of shares, of each order actually executed on the venue; the aggregate number of shares executed at the venue that were priced at or near the mid-point between the bid and the offer; and the percentage of total shares executed that were executed at or near

With regard to the comment that the execution quality statistics currently made public under Rules 605 and 606 are inadequate, the Commission notes that it is considering proposing to amend Rules 600 and 606 to standardize and improve transparency around how broker-dealers handle and route institutional customer orders. These revisions being considered would include addressing commenter concerns regarding disclosures by broker-dealers about the trading venues to which they route orders, particularly with respect to order and execution sizes, fill rates, price improvement, and the use of actionable indications of interests.<sup>521</sup> The Commission also is considering disclosures to facilitate the ability of institutional investors to assess potential conflicts of interest and risks of information leakage.

Request for Comment

488. Do you believe that there is information that the Commission should require NMS Stock ATSS to disclose other than the information that is currently available to market participants from order execution reports pursuant to Exchange Act Rule 605? Why or why not? Please support your arguments. If so, what information should be disclosed and how would the information be useful to market participants? Please explain. Do you believe that there is information that the Commission should require a broker-dealer operator of the NMS Stock ATS to disclose other than the information that is currently available to market participants from order routing reports pursuant to Exchange Act Rules 606? Why or why not? Please support your arguments.

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the midpoint between the bid and the offer. See id. at “Broker Routing Venue Analysis Template Definitions.”

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See id.

489. Do you believe that there are other means by which market quality metrics should be required to be made available by NMS Stock ATSs to market participants, other than as disclosures on proposed Form ATS-N? Why or why not? Please support your arguments. If so, please identify by what means and why? Please support your arguments.
490. Do you believe that an NMS Stock ATS should be required to disclose information about orders entered into its system and the ultimate disposition of such orders? Why or why not? Please support your arguments. For example, should NMS Stock ATSs disclose information regarding the average order size, average execution size, and percentage of orders marked immediate or cancel? Why or why not? Please support your arguments.
491. Do you believe that NMS Stock ATSs should be required to disclose whether the NMS Stock ATS provided order flow and execution statistics to some subscribers and not others? Why or why not? Please support your arguments.
492. Do you believe that NMS Stock ATSs should be required to disclose execution information such as the total number and percentage of shares executed at the midpoint, total number and percentage of shares executed at the national best bid, total number and percentage of shares executed at the national best offer, total number and percentage of shares executed between the national best bid and the midpoint, and total number and percentage of shares executed between the midpoint and the national best offer? Why or why not? Please support your arguments. If so, do you believe such information should be disclosed publicly

on an aggregated basis or should the information be disclosed to each subscriber based on its own orders? Please support your arguments.

493. Do you believe that the joint-industry plan should be amended for publicly disseminating consolidated trade data to require real-time disclosure of the identity of NMS Stock ATSS on reports of their executed trades? Why or why not? Please support your arguments. Alternatively, should executions on NMS Stock ATSS be publicly disseminated on a delayed basis?<sup>522</sup> Why or why not? Please support your arguments. If so, how should this be done and what would be the appropriate delay? Please explain.
494. Do you believe that there are other data elements that should be provided by NMS Stock ATSS in the consolidated trade data? What are they and why should they be required? Please be specific.

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<sup>522</sup>

FINRA Rule 4552 requires each ATS to report to FINRA weekly volume information and number of trades regarding equity securities transactions within the ATS. Each ATS is also required to use a single MPID when reporting information to FINRA and to report weekly aggregate volume information on a security-by-security basis to FINRA.

**IX. Proposed Amendment to Rule 301(b)(10): Written Safeguards and Written Procedures to Protect Confidential Trading Information**

Current Rule 301(b)(10) of Regulation ATS<sup>523</sup> requires every ATS to have in place safeguards and procedures to protect subscribers' confidential trading information and to separate ATS functions from other broker-dealer functions, including proprietary and customer trading.<sup>524</sup> In the Regulation ATS Adopting Release, the Commission recognized that some broker-dealer operators provide traditional brokerage services as well as access to their ATS(s).<sup>525</sup> The Commission further stated that Rule 301(b)(10) was not intended to preclude an ATS from providing its traditional brokerage services; rather, Rule 301(b)(10) was designed to prevent the misuse of private customer information in the system for the benefit of other customers, the ATS's operator, or its employees.<sup>526</sup> The Commission also stated its belief that the sensitive nature of trading information subscribers send to ATSs requires such systems to take certain steps to ensure the confidentiality of such information.<sup>527</sup> To illustrate its point, the Commission provided the example that unless subscribers consent, registered representatives of an ATS should not disclose information regarding trading activities of such subscribers to other subscribers that could not be ascertained from viewing the ATS's screens directly at the time the information is conveyed.<sup>528</sup> As a result of its concerns regarding confidentiality, the

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<sup>523</sup> See 17 CFR 242.301(b)(10).

<sup>524</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70879.

<sup>525</sup> See *id.*

<sup>526</sup> See *id.*

<sup>527</sup> See *id.*

<sup>528</sup> The Commission stated that its concern regarding confidentiality grew out of its inspections of some ECNs, during which the Commission and its staff found that some of the broker-dealers operating ECNs used the same personnel to operate the ECN as they

Commission adopted Rule 301(b)(10), which was designed to eliminate the potential for abuse of the confidential trading information that subscribers send to ATSS.<sup>529</sup>

Rule 301(b)(10), however, does not currently require that the safeguards and procedures mandated under Rule 301(b)(10) be memorialized in writing. The Commission is now proposing to amend Rule 301(b)(10) to require that such safeguards and procedures be reduced to writing.<sup>530</sup> Specifically, the Commission proposes to amend Rule 301(b)(10)(i) to require that all ATSS (including non-NMS Stock ATSS) establish written safeguards and written procedures to protect subscribers' confidential trading information.<sup>531</sup> This would include an ATS adopting written safeguards and written procedures that limit access to the confidential trading information of subscribers to those employees of the ATS who are operating the system or are responsible for its compliance with Regulation ATS or any other applicable rules,<sup>532</sup> and implementing written standards controlling employees of the ATS trading for their own accounts.<sup>533</sup> The Commission is also proposing to amend Rule 301(b)(10)(ii) to require that the

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did for more traditional broker-dealer activities, such as handling customer orders that were received by telephone. These types of situations create the potential for misuse of the confidential trading information in the ECN, such as customers' orders receiving preferential treatment, or customers receiving material confidential information about orders in the ECN. See id.

<sup>529</sup> See id.

<sup>530</sup> As discussed above, proposed Form ATS-N would also require NMS Stock ATSS to describe the written safeguards and procedures. See Part III, Item 10 of Proposed Form ATS-N. See also supra Section VII.B.11.

<sup>531</sup> See proposed Rule 301(b)(10)(i).

<sup>532</sup> See proposed Rule 301(b)(10)(i)(A).

<sup>533</sup> See proposed Rule 301(b)(10)(i)(B).

oversight procedures, which an ATS adopts and implements to ensure that the above safeguards and procedures are followed, be in writing.<sup>534</sup>

The Commission continues to believe that safeguards and procedures to ensure the confidential treatment of ATS subscribers' trading information are important, and that the potential for misuse of such information continues to exist. The Commission preliminarily believes that requiring an ATS to reduce to writing those safeguards and procedures, as well as its oversight procedures to ensure that such safeguards and procedures are followed, would strengthen the effectiveness of the ATS's safeguards and procedures and would better enable the ATS to protect confidential subscriber trading information and implement and monitor the adequacy of, and the ATS's compliance with, its safeguards and procedures. For example, if an ATS were required to reduce its safeguards and procedures to writing, it could self-audit – or if it chose to do so, undergo a third-party audit – for compliance with those safeguards and procedures, and also assess their adequacy. In addition, the Commission preliminarily believes that reducing ATSS' safeguards and procedures under Rule 301(b)(10) to writing will help the Commission and its staff, and the staff of the SRO of which an ATS's broker-dealer operator is a member, evaluate whether an ATS has established such procedures and safeguards, whether the ATS has implemented and is abiding by them, and whether they comply with the requirements of Rule 301(b)(10). This should enable the Commission, and the applicable SRO(s), to exercise more effective oversight of ATSS regarding the ATSS' compliance with Rule 301(b)(10) and other federal securities laws, rules, and regulations. The Commission also preliminary believes that its proposal would benefit market participants because they would be able to better evaluate

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<sup>534</sup> See proposed Rule 301(b)(10)(ii).

the implementation of such safeguards and procedures, due to the proposed rule to reduce those safeguards and procedures to writing.

Request for Comment

495. Do you believe the Commission should require ATSS to reduce to writing their safeguards and procedures as described above? Why or why not? Should the requirement apply to all ATSS or only a subset such as NMS Stock ATSS? Please support your arguments.
496. Do you believe that requiring ATSS to reduce to writing their safeguards and procedures, as proposed, would help to ensure that subscribers' confidential trading information is protected and not misused? If not, why not? Please support your arguments.
497. Are there other conditions that the Commission should implement to achieve the goal of protecting subscribers' confidential trading information? If so, what are they and why would they be preferable? Please be specific.
498. Currently, how common is it for ATSS to reduce to writing their safeguards and procedures to protect subscribers' confidential trading information and/or their oversight procedures to ensure that those safeguards and procedures are followed? For ATSS that have not reduced their safeguards and procedures to protect subscribers' confidential trading information to writing, how do they currently ensure their compliance with the requirements of Rule 301(b)(10)? Please be specific.
499. For ATSS that have not reduced to writing their safeguards and procedures to protect subscribers' confidential trading information and/or their oversight

procedures to ensure that those safeguards and procedures are followed, how long would it take to do so? Please explain.

## X. Recordkeeping Requirements

The Commission is proposing to amend Rules 303(a)(1) and 303(a)(2) of Regulation ATS to reflect its proposed amendments to Rule 301(b)(2)<sup>535</sup> and 301(b)(10),<sup>536</sup> and its proposed addition of Rule 304.<sup>537</sup> In addition, the Commission is proposing to make a minor technical amendment to Rule 303.

Currently, unless not required to comply with Regulation ATS pursuant to Rule 301(a)<sup>538</sup> of Regulation ATS, an ATS must comply with the recordkeeping requirements of Regulation ATS. Specifically, Rule 301(b)(8)<sup>539</sup> requires an ATS to make and keep current the records specified in Rule 302<sup>540</sup> and to preserve the records specified in Rule 303.<sup>541</sup> In the Regulation ATS Adopting Release, the Commission stated that the requirements to make and preserve records set forth in Regulation ATS are necessary to create a meaningful audit trail and permit surveillance and examination to help ensure fair and orderly markets.<sup>542</sup>

Rule 303(a)(1) requires an ATS to preserve certain records for at least three years, the first two years in an easily accessible place.<sup>543</sup> Specifically, Rule 303(a)(1)<sup>544</sup> requires an ATS to preserve: all records required to be made pursuant to Rule 302; all notices provided to

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<sup>535</sup> See supra Section IV.C.

<sup>536</sup> See infra Section IX.

<sup>537</sup> See supra Section IV.C.

<sup>538</sup> 17 CFR 242.301(a).

<sup>539</sup> See 17 CFR 242.301(b)(8).

<sup>540</sup> See 17 CFR 242.302.

<sup>541</sup> See 17 CFR 242.303.

<sup>542</sup> See Regulation ATS Adopting Release, supra note 7, at 70877-78.

<sup>543</sup> See 17 CFR 242.303(a)(1).

<sup>544</sup> See 17 CFR 242.303(a)(1).

subscribers, including notices addressing hours of operation, system malfunctions, changes to system procedures, and instructions pertaining to access to the ATS; documents made or received in the course of complying with the system capacity, integrity, and security standards in Rule 301(b)(6), if applicable,<sup>545</sup> and, if the ATS is subject to the fair access requirements under Rule 304(b)(5),<sup>546</sup> a record of its access standards. Rule 303(a)(2)<sup>547</sup> requires that certain other records must be kept for the life of the ATS and any successor enterprise, including partnership articles or articles of incorporation (as applicable), and copies of reports filed pursuant to Rule 301(b)(2),<sup>548</sup> which includes current Form ATS, and records made pursuant to Rule 301(b)(5).<sup>549</sup> In particular, reports required to be maintained for the life of the ATS or any successor enterprise include initial operation reports, amendments, and cessation of operations reports, filed on Form ATS.<sup>550</sup>

The Commission is proposing to amend the record preservation requirements of Rule 303 to incorporate the preservation of records that would be created pursuant to the proposed requirements that NMS Stock ATSs file Forms ATS-N, Form ATS-N Amendments, and notices of cessation instead of Form ATS. Specifically, the Commission is proposing to amend Rule 303(a)(2)(ii) to require that an ATS shall preserve, for the life of the enterprise and of any successor enterprise, copies of reports filed pursuant to Rule 301(b)(2) or – in the case of an

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<sup>545</sup> See supra notes 96-100 and accompanying text.

<sup>546</sup> See supra notes 92-95 and accompanying text.

<sup>547</sup> See 17 CFR 242.303(a)(2).

<sup>548</sup> See 17 CFR 242.301(b)(2).

<sup>549</sup> See supra notes 92-95 and accompanying text.

<sup>550</sup> See 17 CFR 242.301(b)(2).

NMS Stock ATS – Rule 304, and records made pursuant to Rule 301(b)(5).<sup>551</sup> As a result, because an NMS Stock ATS would be required to file Forms ATS-N, Form ATS-N Amendments, and notices of cessation pursuant to proposed Rule 304, instead of on Form ATS, the NMS Stock ATS would be required to preserve those reports for the life of the enterprise and of any successor enterprise pursuant to the proposed amendments to Rule 303(a)(2).<sup>552</sup> The Commission is not proposing any amendments to the recordkeeping requirements of Rule 302, or any other amendments to the record preservation requirements of Rule 303(a)(2).

The Commission is also proposing amendments to the record preservation requirements of Rule 303(a)(1) to incorporate the Commission's proposed amendments to Rule 301(b)(10),<sup>553</sup> which would require an ATS to reduce to writing its safeguards and procedures to ensure confidential treatment of subscribers' trading information and the oversight procedures to ensure that those safeguards and procedures are followed.<sup>554</sup> Accordingly, the Commission is proposing to require an ATS, for a period of not less than three years, the first two years in an easily accessible place, to preserve at least one copy of the written safeguards and written procedures to protect subscribers' confidential trading information and the written oversight procedures created in the course of complying with Rule 301(b)(10).<sup>555</sup> The Commission is not proposing to amend any other aspects of the records preservation requirements of Rule 303(a)(1). The Commission

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<sup>551</sup> See proposed Rule 301(a)(2)(ii).

<sup>552</sup> The Commission notes that an NMS Stock ATS that had previously made filings on Form ATS would be required to preserve those filings for the life of the enterprise, as well as filings made going forward on Form ATS-N.

<sup>553</sup> See proposed Rule 301(b)(10).

<sup>554</sup> See supra Section VII (discussing the Commission's proposed amendments to Rule 301(b)(10)).

<sup>555</sup> See proposed Rule 303(a)(1)(v).

preliminarily believes that the proposed amendments to Rule 303 are necessary to create a meaningful audit trail of an ATS's current and previous written safeguards and procedures pursuant to Rule 301(b)(2) and permit surveillance and examination to help ensure fair and orderly markets,<sup>556</sup> without imposing any undue burden on ATSS.

Finally, the Commission proposes to make a minor technical amendment to Rule 303(a). Currently, Rule 303(a) references "paragraph (b)(9) of § 242.301" when setting forth the record preservation requirements for ATSS. The Commission is proposing to change the above reference to "paragraph (b)(8) of § 242.301" because Rule 301(b)(8) sets forth the recordkeeping requirements for ATSS.

#### Request for Comment

500. Do you believe the Commission should amend the recordkeeping requirements for ATSS as proposed? Why or why not?

501. Do you believe that there are any other requirements of Rule 303 that should be amended to satisfy the objectives of this proposal? If so, what are they and why?

502. Do you believe that the proposed amendments to the record preservation requirements of Rule 303 are reasonable? If not, why? Please support your arguments.

#### **XI. General Request for Comment**

The Commission is requesting comments from all members of the public. The Commission particularly requests comment from the point of view of persons who operate ATSS

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<sup>556</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70877-78.

that would meet the proposed definition of NMS Stock ATS, subscribers to those systems, investors, and registered national securities exchanges. The Commission seeks comment on all aspects of the proposed rule amendments and proposed form, particularly the specific questions posed above. Commenters should, when possible, provide the Commission with data to support their views. Commenters suggesting alternative approaches should provide comprehensive proposals, including any conditions or limitations that they believe should apply, the reasons for their suggested approaches, and their analysis regarding why their suggested approaches would satisfy the objectives of the proposed amendments. The Commission will carefully consider the comments it receives.

503. Do you believe that there is other information about the nature or extent of the operations of an NMS Stock ATS that should be disclosed on proposed Form ATS-N? Are there specific topics about which the Commission should request more information? If so, what information should be disclosed and why?
504. Do you believe that there are activities of an NMS Stock ATS broker-dealer operator and its affiliates that may give rise to potential conflicts of interest, other than those described, that should be disclosed on Form ATS-N? If so, what information should be disclosed and why? If so, what are they and why?
505. Is there other information or data that would be useful for a market participant to consider when evaluating an NMS Stock ATS as a potential trading center for its orders? If so, what are they and why?

## XII. Paperwork Reduction Act

Certain provisions of the proposal contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).<sup>557</sup> The titles of these requirements are:

- Requirements for Alternative Trading Systems That Are Not National Securities Exchanges – Rule 301, Form ATS and Form ATS-R, 17 CFR 242.301 (OMB Control No. 3235-0509);
- Rule 303 (17 CFR 242.303) Record Preservation Requirements for Alternative Trading Systems (OMB Control No. 3235-0505).
- Rule 304 and Form ATS-N (a proposed new collection of information).

We are submitting these requirements to the Office of Management and Budget (“OMB”) for review and approval in accordance with the PRA and its implementing regulations.<sup>558</sup> We are applying for an OMB control number for the proposed new collection of information in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. If adopted, responses to the new collection of information would be mandatory. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.<sup>559</sup>

### A. Summary of Collection of Information

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<sup>557</sup> 44 U.S.C. 3501 et seq.

<sup>558</sup> 44 U.S.C. 3507; 5 CFR 1320.11.

<sup>559</sup> 5 CFR 1320.11(l).

The proposed amendments to Regulation ATS include two new categories of obligations that would require a collection of information within the meaning of the PRA. The first category relates to Rule 301(b)(10) of Regulation ATS<sup>560</sup> and would apply to all ATSS, while the second category relates to proposed Form ATS-N and would apply only to NMS Stock ATSS.

**1. Requirements Relating to Rule 301(b)(10) of Regulation ATS**

Under Rule 301(b)(10) of Regulation ATS, all ATSS are currently required to: (1) establish adequate safeguards and procedures to protect subscribers' confidential trading information; and (2) adopt and implement adequate oversight procedures to ensure that the safeguards and procedures established to protect subscribers' confidential trading information are followed. Rule 301(b)(10) of Regulation ATS further requires that the safeguards and procedures to protect subscribers' confidential trading information shall include: (1) limiting access to the confidential trading information of subscribers to those employees of the ATS who are operating the system or responsible for its compliance with Regulation ATS or any other applicable rules; and (2) implementing standards controlling employees of the ATS trading for their own accounts. The proposed amendments to Regulation ATS would require written safeguards and written procedures to protect subscribers' confidential trading information and written oversight procedures to ensure that the safeguards and procedures are followed.

In addition, the Commission proposes to amend Rule 303(a)(1)<sup>561</sup> of Regulation ATS to provide that all ATSS must preserve at least one copy of their written safeguards and written procedures to protect subscribers' confidential trading information and the written oversight

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<sup>560</sup> 17 CFR 242.301(b)(10).

<sup>561</sup> 17 CFR 242.303(a)(1).

procedures created in the course of complying with Rule 301(b)(10) of Regulation ATS. Under the proposed amendment, Rule 303(a)(1)(v) would be added to Regulation ATS to require an ATS to preserve such written safeguards and written procedures, and written oversight procedures for a period of not less than three years, the first two years in an easily accessible place.<sup>562</sup>

**2. Requirements Relating to Proposed Rules 301(b)(2)(viii) and 304 of Regulation ATS, including Proposed Form ATS-N**

As described above, the Commission proposes that any ATS that meets the definition of an NMS Stock ATS would be required to complete Form ATS-N and file it with the Commission in a structured format. Upon the Commission declaring a Form ATS-N effective, the Commission would make the Form ATS-N publicly available. The Commission would also make publicly available upon filing all properly filed Form ATS-N Amendments and notices of cessation on Form ATS-N. The proposed amendments to Regulation ATS would also require each NMS Stock ATS to make public via posting on its website a direct URL hyperlink to the Commission's website that contains the documents enumerated in proposed Rule 304(b)(2).

Proposed Form ATS-N consists of five parts. First, the entity submitting the filing would indicate whether it is submitting or withdrawing an initial filing. The entity would also indicate the type of filing — whether the filing is a Form ATS-N, a Form ATS-N Amendment (whether a material amendment, periodic amendment, or correcting amendment), or a notice of cessation, and if it is a notice of cessation, the date the NMS Stock ATS will cease to operate. If the filing is a Form ATS-N Amendment, the NMS Stock ATS would also be required to provide a brief narrative description of the amendment and a redline(s) showing changes to Part III and/or Part IV.

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<sup>562</sup> Id.

of proposed Form ATS-N. Part I would require that entity to state the name of the Registered Broker Dealer of the NMS Stock ATS (i.e., the broker-dealer operator), the name under which the NMS Stock ATS conducts business, if any, the MPID of the NMS Stock ATS, and whether it is an NMS Stock ATS currently operating pursuant to a previously filed initial operation report on Form ATS. Part II would require registration information regarding the broker-dealer operator of the ATS, such as the broker-dealer's file number with the Commission, the name of the national securities association with which the broker-dealer operator is a member, the effective dates of the broker-dealer's registration with the Commission and membership in the national securities association, and the broker-dealer operator's CRD Number. In addition, Part II would require the address of the physical location of the NMS Stock ATS matching system, the NMS Stock ATS's mailing address, and a URL to the website of the NMS Stock ATS. Part II would also require information regarding the legal status of the broker-dealer operator of the NMS Stock ATS (e.g., corporation, partnership, sole proprietorship) and its date of formation. Furthermore, Part II of proposed Form ATS-N would require the NMS Stock ATS to attach the following three exhibits: (1) Exhibit 1 – a copy of any materials currently provided to subscribers or other persons related to the operations of the NMS Stock ATS or the disclosures on Form ATS-N; (2) Exhibit 2A – a copy of the most recently filed or amended Schedule A of the broker-dealer operator's Form BD disclosing information relating to direct owners and executive officers; and (3) Exhibit 2B – a copy of the most recently filed or amended Schedule B of the broker-dealer operator's Form BD disclosing information related to indirect owners. In lieu of attaching Exhibits 2A and 2B to proposed Form ATS-N, the NMS Stock ATSS would be able to provide a URL address for where the required documents can be found.

Part III of proposed Form ATS-N would require an NMS Stock ATS to provide certain disclosures related to the activities of the broker-dealer operator and its affiliates in connection with the NMS Stock ATS. Part III consists of ten items, which are summarized here, and explained in greater detail below in the discussion of the estimated burdens related to each disclosure requirement. Part III of proposed Form ATS-N would include disclosures relating to:

- (1) whether the broker-dealer operator, or any of its affiliates, operate or control any non-ATS trading centers and how such non-ATS trading centers coordinate or interact with the NMS Stock ATS, if at all;
- (2) whether the broker-dealer operator, or any of its affiliates, operates another NMS Stock ATS and how such other NMS Stock ATS coordinates or interacts with the NMS Stock ATS completing the Form ATS-N, if at all;
- (3) the products and services offered by the broker-dealer operator, or any of its affiliates, to subscribers in connection with their use of the NMS Stock ATS;
- (4) whether the broker-dealer operator, or any of its affiliates, has any formal or informal arrangement with an unaffiliated person(s), or affiliate(s) of such person(s), that operates a trading center regarding access to the NMS Stock ATS, including preferential routing arrangements;
- (5) whether the broker-dealer operator or any of its affiliates enter orders or other trading interest on the NMS Stock ATS and the manner in which such trading is done;
- (6) whether the broker-dealer operator or any of its affiliates use a SOR(s) (or similar functionality), an algorithm(s), or both to send or receive orders or other trading interest to or from the NMS Stock ATS, and the interaction or coordination between the SOR(s) (or similar functionality) or algorithm(s) and the NMS Stock ATS;
- (7) whether there are any employees of the broker-dealer operator that service the operations of the NMS Stock ATS that also service any other business unit(s) of the broker-dealer operator or any affiliate(s) other than the NMS Stock ATS, and the roles and responsibilities of such shared employees;
- (8) whether any

operation, service, or function of the NMS Stock ATS is performed by any person(s) other than the broker-dealer operator, a description of such operation, service, or function, and whether those person(s), or any of their affiliates, may enter orders or other trading interest on the NMS Stock ATS; (9) whether the NMS Stock ATS makes available or applies any service, functionality, or procedure of the NMS Stock ATS to the broker-dealer operator or its affiliates that is not available or does not apply to a subscriber(s) to the NMS Stock ATS and a description of such service, functionality, or procedure; and (10) a description of the written safeguards and written procedures to protect the confidential trading information of subscribers to the NMS Stock ATS, including (a) a description of the means by which a subscriber can consent or withdraw consent to the disclosure of confidential trading information, (b) identification of the positions or titles of any persons that have access to confidential trading information, the type of confidential trading information those persons can access, and the circumstances under which they can access it, (c) a description of the written standards controlling employees of the NMS Stock ATS trading for their own accounts, and (d) a description of the written oversight procedures to ensure that the ATS's Rule 301(b)(10) safeguards and procedures are implemented and followed.

Part IV of proposed Form ATS-N would require an NMS Stock ATS to provide certain disclosures related to the manner of operations of the NMS Stock ATS. Part IV consists of 15 items, which are summarized here, and explained in greater detail below in the discussion of the estimated burdens related to each disclosure requirement. Part IV of proposed Form ATS-N would include disclosures relating to: (1) subscribers to the NMS Stock ATS, including any eligibility requirements to gain access to the services of the ATS, the terms or conditions of any contractual agreement for access, the types of subscribers and other persons that use the services

of the ATS, any formal or informal arrangement the NMS Stock ATS may have with a subscriber or person to provide liquidity to the ATS (including the terms and conditions of each arrangement and the identity of any liquidity provider that is an affiliate of the broker-dealer operator), the circumstances by which a subscriber or other person may be limited or denied access to the NMS Stock ATS, and any differences in the treatment of different subscribers and persons with respect to eligibility, terms and conditions of use, criteria for distinguishing among subscribers or other persons, and limitations and denials of access; (2) the days and hours of operation of the NMS Stock ATS, including the times when orders or other trading interest are entered and the time when pre-opening or after-hours trading occur, and whether there are any differences in when orders or other trading interest may be entered by different subscribers or persons; (3) the order types and modifiers entered on the NMS Stock ATS, including their characteristics, operations, how they are ranked and executed on the ATS (such as priority vis-à-vis other orders), eligibility and conditions for routing to other trading centers, the available time-in-force instructions for each order type, whether the availability and terms and conditions of each order type is the same for all subscribers and persons, any requirements and handling procedures for minimum order sizes, odd-lot orders or mixed-lot orders, including whether such requirements and procedures are the same for all subscribers and persons, and any messages sent to or received by the NMS Stock ATS indicating trading interest, including any differences in the terms and conditions for such messages for different subscribers and persons; (4) the means by which subscribers and other persons connect to the NMS Stock ATS and enter orders or other trading interest on the NMS Stock ATS (e.g., direct FIX connection or indirect connection via the broker-dealer/operator's SOR or any intermediate functionality, algorithm or sales desk); any co-location services or other means by which any subscriber or other persons may enhance the

speed by which to send or receive orders, trading interest, or messages to or from the NMS Stock ATS; and any differences in the terms and conditions for connecting and entering trading interest or co-location services for different subscribers or persons; (5) the segmentation of orders or other trading interest on the NMS Stock ATS and notice about segmentation to subscribers or persons, including the criteria used to segment orders or other trading interest on the NMS Stock ATS, any notice provided to subscribers or persons about the segmented category that a subscriber or a person is assigned, any differences in segmentation (or notice about segmentation) for different subscribers or persons, and order preferencing and its effect on order priority and interaction; (6) the means and circumstances by which orders or other trading interest on the NMS Stock ATS are displayed or made known outside the NMS Stock ATS, type of information displayed, any differences in display for different subscribers and persons, and to whom orders and trading interest is displayed; (7) the trading services of the NMS Stock ATS, including the means used by the ATS to bring multiple buy and sell orders together, the established, non-discretionary methods dictating the terms of trading on the facilities of the NMS Stock ATS, trading procedures related to price protection mechanisms, short sales, locked-crossed markets, the handling of execution errors, time-stamping of orders and executions, or price improvement functionality, and any differences for different subscribers and persons; (8) the procedures governing trading in the event the NMS Stock ATS suspends trading or experiences a system disruption or malfunction, including any differences in the procedures among subscribers and persons; (9) the opening, reopening or closing processes, or after-hours trading procedures of the NMS Stock ATS; (10) the circumstances under which orders or other trading interest are routed from the NMS Stock ATS to another trading center, and any differences in the means by which orders are routed among subscribers and persons; (11) the

market data used by the NMS Stock ATS and the source of that market data, and the specific purpose for which market data is used by the ATS, including how it is used to determine the NBBO; (12) the fees, rebates, or other charges of the NMS Stock ATS and whether such fees are not the same for all subscribers and persons; (13) arrangements or procedures for trade reporting of transactions on the NMS Stock ATS, and arrangements or procedures undertaken by the NMS Stock ATS to facilitate the clearance and settlement of transaction on the ATS, including any differences in these procedures among subscribers and persons; (14) information related to the NMS Stock ATS's order display and execution obligations under Rule 301(b)(3) of Regulation ATS, if applicable; (15) information related to the NMS Stock ATS's obligations under the fair access requirements of Rule 301(b)(5) of Regulation ATS, if applicable; and (16) aggregate market quality statistics published or provided to one or more subscribers.

Part V of proposed Form ATS-N would require an NMS Stock ATS to provide certain basic information about the point of contact for the NMS Stock ATS, such as the point of contact's name, title, telephone number and email address. Part V would also require the NMS Stock ATS to consent to service of any civil action brought by, or any notice of any proceeding before, the Commission or an SRO in connection with the ATS's activities.

The Commission proposes that Form ATS-N would be filed electronically and require an electronic signature. Consequently, the proposed amendments to Regulation ATS would require that every NMS Stock ATS have the ability to file forms electronically with an electronic signature. The Commission preliminarily believes that most, if not all, ATSs that transact in NMS stock currently have the ability to access and submit an electronic form such that the requirement to file Form ATS-N electronically with an electronic signature would not impose

new implementation costs. The burdens related to electronic submission and providing an electronic signature are included in the burden hour estimates provided below.

In addition, the Commission proposes to amend Rule 303(a)(2)(ii)<sup>563</sup> of Regulation ATS to provide that all ATSS must preserve copies of all reports filed pursuant to Rule 304, which includes Form ATS-N filings, for the life of the enterprise and any successor enterprise.

Furthermore, under this proposal, an ATS that effects transactions in both NMS stocks and non-NMS stocks would be required to file both a Form ATS-N with respect to its trading of NMS stocks and a revised Form ATS that removes discussion of those aspects of the ATS related to the trading of NMS stocks. The ATS would also be required to file two Forms ATS-R – one to report its trading volume in NMS stocks and another to report its trading volume in non-NMS stocks.

## **B. Proposed Use of Information**

### **1. Proposed Amendments to Rules 301(b)(10) of Regulation ATS**

As noted above, the proposed amendments to Rule 301(b)(10) of Regulation ATS would require all ATSS to have in place written safeguards and written procedures to protect subscribers' confidential trading information. Proposed Rule 303(a)(1)(v) of Regulation ATS would require all ATSS to preserve at least one copy of those written safeguards and written procedures.

The Commission preliminarily believes that both the Commission and the SRO of which the ATS's broker dealer-operator is a member will use these written safeguards and written procedures in order to better understand how each ATS protects subscribers' confidential trading

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<sup>563</sup> 17 CFR 242.303(a)(2)(ii).

information from unauthorized disclosure and access. The Commission preliminarily believes that the information contained in the records required to be preserved by proposed Rule 303(a)(1)(v) would be used by examiners and other representatives of the Commission, state securities regulatory authorities, and SROs to evaluate whether ATSS are in compliance with Regulation ATS as well as other applicable rules and regulations. The Commission also preliminarily believes that the proposed requirements to memorialize in writing the safeguards and procedures to protect subscribers' confidential trading information would assist ATSS in more effectively complying with their existing legal requirements under Regulation ATS; in particular, the requirements to protect the confidentiality of subscribers' trading information under Rule 301(b)(10) of Regulation ATS.

**2. Proposed Rules 301(b)(2)(viii), 304 of Regulation ATS, Including Proposed Form ATS-N, and 301(b)(9)**

Proposed Rules 301(b)(2)(viii) and 304 of Regulation ATS would require each NMS Stock ATS to file a Form ATS-N, Form ATS-N Amendments, and a notice of cessation on proposed Form ATS-N.<sup>564</sup> As noted above, proposed Form ATS-N would require information regarding the broker-dealer operator of the NMS Stock ATS and, in some instances affiliates of

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<sup>564</sup> Specifically, proposed Rule 304(a)(1) would require an NMS Stock ATS to file a Form ATS-N prior to the NMS Stock ATS commencing operations. Proposed Rule 304(a)(2)(i) would require an NMS Stock ATS to file amendments to its proposed Form ATS-N: (A) At least 30 calendar days prior to the date of implementation of a material change to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that are subject to disclosure on Form ATS-N; (B) within 30 calendar days after the end of each calendar quarter to correct any other information on proposed Form ATS-N that has become inaccurate; or (C) promptly, to correct any information on proposed Form ATS-N that was inaccurate when originally filed. Proposed Rule 304(a)(3) would require an NMS Stock ATS to notice its cessation of operations at least 10 business days before the date on which the NMS Stock ATS ceases operation.

the broker-dealer operator, and the operation of the NMS Stock ATS, including detailed disclosures regarding the ATS's method of operation, order types and access criteria.

Additionally, an ATS that effects transactions in both NMS stocks and non-NMS stocks would be required to file both a Form ATS-N with respect to its trading of NMS stocks and a revised Form ATS that removes discussion of those aspects of the ATS relating to the trading of NMS stocks.<sup>565</sup> Under the proposed amendments to Rule 301(b)(9), an ATS that effects trades in both NMS stocks and non-NMS stocks would be required to file two Forms ATS-Rs – one reporting its trading volume in NMS stocks and the other reporting its trading volume in non-NMS stocks.<sup>566</sup> The information filed on proposed Form ATS-N would be publicly available on the Commission's website and each NMS Stock ATS would be required to post on the NMS Stock ATS's website a direct URL hyperlink to the Commission's website that contains the documents enumerated in proposed Rule 304(b)(2), but information filed on Forms ATS and ATS-R would be kept confidential, subject to the provisions of current applicable law.

The Commission preliminarily believes that market participants would use the information publicly disclosed on proposed Form ATS-N to source, evaluate, and compare and contrast information about different NMS Stock ATSs, including information relating to the broker-dealer operator and any potential conflicts of interests it may have with respect to its operation of the NMS Stock ATS. The Commission also preliminarily believes that market participants would use the information publicly disclosed on proposed Form ATS-N to source, evaluate, and compare and contrast information about, among other things, an NMS Stock ATS's

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<sup>565</sup> See proposed Rule 301(b)(2)(viii).

<sup>566</sup> See proposed Rule 301(b)(9).

eligibility requirements, trading hours, order types, connection and order entry functionalities, segmentation of order flow, display of orders and other trading interests, trading platform functionality, procedures governing trading during a suspension of trading, system disruption, or system malfunction, opening, closing, and after-hours trading processes or procedures, routing procedures, market data usages and sources, fees, trade reporting, clearing, and settlement, order display and execution access standards, fair access standards, and market quality statistics published or provided to one or more subscribers. Accordingly, the Commission preliminarily believes that market participants would use the information disclosed on proposed Form ATS-N to better evaluate to which trading venue they may want to subscribe and/or route orders for execution in order to accomplish their investing or trading objectives.

The Commission preliminarily believes it will use the information disclosed on proposed Form ATS-N, Form ATS, and Form ATS-R to oversee the growth and development of NMS Stock ATSS, including those that also effect transactions in non-NMS stocks, and to evaluate whether those systems operate in a manner consistent with the federal securities laws should the disclosures provided on Form ATS-N reveal potential non-compliance with federal securities laws. In particular, the Commission preliminarily believes that the information collected and reported to the Commission by NMS Stock ATSS would enable the Commission to evaluate better the operations of NMS Stock ATSS with regard to the Commission's duty under the Exchange Act to remove impediments to and perfect the mechanisms of a national market system for securities<sup>567</sup> and evaluate the competitive effects of these systems to ascertain whether

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<sup>567</sup> See 15 U.S.C. 78b (providing that the necessity for the Exchange Act is, among other things, "to require appropriate reports, to remove impediments to and perfect the

the regulatory framework remains appropriate to the operation of such systems. The information provided on Form ATS-N should also assist the SRO for the broker-dealer operator in exercising oversight over the broker-dealer operator. For example, by having to describe their safeguards and procedures to protect the confidential trading information of subscribers, and knowing that such descriptions will be public, NMS Stock ATSS may be encouraged to carefully consider the adequacy of their means of protecting the confidential trading information of subscribers.

The Commission also proposes to amend Rule 303(a)(2)(ii) of Regulation ATS to provide that all ATSS must preserve copies of all reports filed pursuant to proposed Rule 304 for the life of the enterprise and any successor enterprise. The Commission preliminarily believes that the information contained in the records required to be preserved by the proposed amendment to Rule 303(a)(2)(ii) would be used by examiners and other representatives of the Commission, state securities regulatory authorities, and SROs to evaluate whether ATSS are in compliance with Regulation ATS as well as other applicable rules and regulations.

### **C. Respondents**

The “collection of information” requirements under the proposed amendments to Regulation ATS relating to Rule 301(b)(10) and proposed Rule 303(a)(1)(v), as described above, would apply to all ATSS, including NMS Stock ATSS. The “collection of information” requirements under the proposed amendments to Regulation ATS relating to proposed Rule 304, Form ATS-N, and the proposed amendments to Rule 303(a)(2)(ii), as described above, would apply only to NMS Stock ATSS, and the “collection of information” requirements under the

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mechanisms of a national market system for securities . . . and to impose requirements necessary to make such regulation and control reasonably complete and effective . . .”).

proposed amendments to Rule 301(b)(9), as described above, would apply to NMS Stock ATSS that also effect trades in both NMS stocks and non-NMS stocks.

Currently, there are 84 ATSS that have filed Form ATS with the Commission. Of these 84 ATSS, 46 would meet the definition of an NMS Stock ATS.<sup>568</sup> Accordingly, the Commission estimates that 84 entities would be required to comply with the proposed amendments related to Rule 301(b)(10) of Regulation ATS and 46 entities would be required to complete Form ATS-N.<sup>569</sup>

In addition, the Commission notes that there are currently 11 ATSS that trade, or have indicated in Exhibit B to their Form ATS that they expect to trade, both NMS stocks and non-NMS stocks on the ATS.<sup>570</sup> Under the proposed amendments to Regulation ATS, these 11 entities would be required to file a Form ATS-N to disclose information about their NMS stock activities and file a Form ATS to disclose information about their non-NMS stock activities.

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<sup>568</sup> Data compiled from Form ATS submitted to the Commission as of November 1, 2015. That is, 46 ATS have disclosed on their Form ATS that they trade or expect to trade NMS stock.

<sup>569</sup> The Commission recognizes that there may be new entities that will seek to become ATSS, or NMS Stock ATSS, that would be required to comply with the proposed amendments to Rule 301(b)(10). From 2012 through the first half of 2015, there has been an average of 8 Form ATS initial operation reports filed each year with the Commission. Similarly, there may be some ATSS that may cease operations in the normal course of business or possibly in response to the proposed amendments to Regulation ATS. From 2012 through the first half of 2015, there has been an average of 11 ATSS, including those that trade NMS stocks, that have ceased operations. For the purposes of this paperwork burden analysis, the Commission assumes that there are 84 respondents that would be required to comply with the proposed amendments to Rule 301(b)(10), if adopted. The Commission is estimating that the number of entities that may file a Form ATS initial operation report would generally offset any ATSS that may file a Form ATS cessation of operations report.

<sup>570</sup> Data compiled from Forms ATS and ATS-R submitted to the Commission as of November 1, 2015. These 11 ATSS are included within the 46 NMS Stock ATSS.

Consequently, these 11 ATSs would have to amend their Forms ATS to remove discussion of those aspects of the ATS related to the trading of NMS stocks and on an ongoing basis, file separate Forms ATS-R to report trading volume in NMS stocks and trading volume in non-NMS stocks.<sup>571</sup>

With respect to proposed Form ATS-N, the Commission recognizes there may be entities that might file a Form ATS-N to operate an NMS Stock ATS in the future. From 2012 through the first half of 2015, there has been an average of 2 new ATSs per year that disclose that they trade or expect to trade NMS stocks on their initial operation reports, which would therefore fall within the proposed definition of an NMS Stock ATS. Similarly, some ATSs that currently trade NMS stocks may choose to cease operations rather than comply with the proposed amendments requiring them to file proposed Form ATS-N. Other ATSs may choose to cease operations in the normal course of business. From 2012 through the first half of 2015, there has been an average of 6 ATSs that trade NMS stocks that have ceased operations each year.

The Commission preliminarily believes that most ATSs that currently trade NMS stocks would continue to operate notwithstanding the proposed amendments to Regulation ATS. For the purposes of this analysis of the paperwork burden associated with the proposed amendments to Regulation ATS, the Commission assumes that there will be 46 respondents. The Commission preliminarily believes that this number is reasonable, as it assumes that most ATSs that currently

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<sup>571</sup> Pursuant to Rule 301(b)(9), all ATSs are required to file Form ATS-R within 30 calendar days after the end of each calendar quarter in which the market has operated, and within 10 calendar days after the ATS ceases to operate. For ATSs that trade both NMS stocks and non-NMS stocks, the ATS would report its transactions in NMS stocks on one Form ATS-R, and its transaction volume in other securities on a separate Form ATS-R.

trade NMS stocks would file a Form ATS-N with the Commission, and acknowledges that there may be some ATSS that cease operations altogether and other entities that may choose to commence operations as an NMS Stock ATS. Based on the number of initial filings and cessation of operations reports on current Form ATS for ATSS that trade NMS stocks described above, the Commission estimates that, 2 to 3 new entities will file to become an NMS Stock ATS and 4 to 6 NMS Stock ATSS will cease operations in each of the next three years.

#### **D. Total Initial and Annual Reporting and Recordkeeping Burdens**

##### **1. Proposed Rules 301(b)(10) and 303(a)(1)(v) of Regulation ATS**

###### **a. Baseline Measurements**

Under current Rule 301(b)(10) of Regulation ATS,<sup>572</sup> all ATSS must establish adequate safeguards and procedures to protect subscribers' confidential trading information, as well as oversight procedures to ensure such safeguards and procedures are followed. As noted above, the Commission preliminarily believes that ATSS – in particular, ATSS whose broker-dealer operators are large, multi-service broker-dealers – generally have and maintain in writing their safeguards and procedures to protect subscribers' confidential trading information, as well as the oversight procedures to ensure such safeguards and procedures are followed.<sup>573</sup> However, neither Rule 301(b)(10) nor Rule 303(a)(1) of Regulation ATS currently requires that an ATS have and preserve those safeguards and procedures in writing.

For ATSS that currently have and preserve in written format the safeguards and procedures to protect subscribers' confidential trading information under Rule 301(b)(10) of

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<sup>572</sup> 17 CFR 242.301(b)(10).

<sup>573</sup> See supra Section XIII.B.4.

Regulation ATS, the Commission preliminarily estimates that the average annual burden they voluntarily undertake to update and preserve those written safeguards and written procedures is 4 hours.<sup>574</sup> Because neither current Rule 301(b)(1) nor current Rule 303(a)(1) requires an ATS to have and preserve its safeguards and procedures to protect subscribers' confidential trading information in writing, this burden is not reflected in the current PRA baseline burdens for Rules 301 and 303.<sup>575</sup> As such, in accordance with the below analysis, the Commission would modify the current PRA burdens for Rules 301 and 303 to account for the proposed requirement that ATSs have and preserve in written format the safeguards and procedures to protect subscribers' confidential trading information.<sup>576</sup>

**b. Burden**

The Commission recognizes that proposed Rules 301(b)(10) and 303(a)(1)(v) of Regulation ATS would impose certain burdens on respondents. For ATSs that currently have and preserve in written format the safeguards and procedures to protect subscribers' confidential trading information and written oversight procedures to ensure such safeguards and procedures are followed, the Commission preliminarily believes that there will be no increased burden under the proposed amendments to Rules 301(b)(10) and 303(a)(1)(v) of Regulation ATS. The

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<sup>574</sup> Attorney at 2 hours + Compliance Clerk at 2 hours = 4 burden hours. For ATSs that do not have their safeguards and procedures or oversight procedures in a written format, these firms would incur a one-time initial burden to record their safeguards and procedures as well as their oversight procedures in a written format as described below.

<sup>575</sup> See FR Doc. 2014-02143, 79 FR 6236 (February 3, 2014) (Request to OMB for Extension of Rule 301 and Forms ATS and ATS-R; SEC File No. 270-451; OMB Control No. 3235-0509) (hereinafter "Rule 301 PRA Update"); FR Doc. 2013-17474, 78 FR 43943 (July 22, 2013) (Request to OMB for Extension of Rule 303; SEC File No. 270-450; OMB Control No. 3235-0505) (hereinafter "Rule 303 PRA Update").

<sup>576</sup> See infra note 582 and accompanying text.

Commission preliminarily believes that the current practices of those ATSS would already be in compliance with the proposed rules. Therefore, the proposed amendments should not require those ATSS to take any measures or actions in addition to those currently undertaken.

For ATSS that have not recorded in writing their safeguards and procedures to protect subscribers' confidential trading information and oversight procedures to ensure such safeguards and procedures are followed, there will be an initial, one-time burden to memorialize them in a written document(s). The Commission preliminarily estimates that an ATSS's initial, one-time burden to put in writing its safeguards and procedures to protect subscribers' confidential trading information and the oversight procedures to ensure such safeguards and procedures are followed would be approximately 8 hours,<sup>577</sup> but the Commission preliminarily estimates that the burden could range between 5 and 10 hours.<sup>578</sup> Because ATSS are already required to have safeguards and procedures to protect subscribers' confidential trading information and to have oversight procedures to ensure such safeguards and procedures are followed, the Commission preliminarily believes that recording these items in a written format would not impose a substantial burden on ATSS. Consequently, the Commission preliminarily believes that ATSS would rely on internal staff to record the ATSS's Rule 301(b)(10) procedures in writing. The Commission preliminarily estimates that, of the 84 current ATSS, 15 ATSS might not have their safeguards and procedures to protect subscribers' confidential trading information or oversight procedures to ensure such safeguards and procedures are followed in writing, and would therefore be subject to this one-time

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<sup>577</sup> Attorney at 7 hours + Compliance Clerk at 1 hour = 8 burden hours.

<sup>578</sup> Attorney at 4-9 hours + Compliance Clerk at 1 hour = 5-10 burden hours.

initial burden.<sup>579</sup> Accordingly, the Commission preliminarily estimates that the aggregate initial, one-time burden on all ATSs would be 150 hours based on the Commission's highest approximation of the additional burden per ATS.<sup>580</sup>

As explained above, the Commission preliminarily estimates that the average annual, ongoing burden per ATS to update and preserve written safeguards and written procedures to protect subscribers' confidential trading information, as well as to update and preserve the written standards controlling employees of the ATS trading for their own account and the written oversight procedures, would be 4 hours.<sup>581</sup> As a result, the Commission preliminarily estimates that the total aggregate, ongoing burden per year for all ATSs would be 336 hours,<sup>582</sup> and thus, the Commission is modifying the current PRA burden estimates for Rules 301 and 303 to account for this increased burden on ATSs.

## **2. Proposed Rules 301(b)(2)(viii) and 304 of Regulation ATS, including Proposed Form ATS-N**

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<sup>579</sup> It is likely that most, if not all, ATSs fulfill their Rule 301(b)(10) obligations in writing, given the practical difficulty in ensuring such safeguards and procedures, as well as oversight procedures, are "adequate," as required under Rule 301(b)(10), and contain all necessary components. The Commission solicits comment on the accuracy of this estimate.

<sup>580</sup> (Attorney at 9 hours + Compliance Clerk at 1 hour) x (15 ATSs) = 150 burden hours. See supra note 578 and accompanying text.

<sup>581</sup> See supra note 574 and accompanying text.

<sup>582</sup> (Attorney at 2 hours + Compliance Clerk at 2 hours) x 84 ATSs = 336 burden hours.

**a. Baseline Measurements**

Currently, Rule 301(b)(2)(i) of Regulation ATS<sup>583</sup> requires an ATS to file an initial operation report on current Form ATS at least 20 days prior to commencing operation as an alternative trading system. Current Form ATS requires information regarding the operation of the ATS, including, among other things, classes of subscribers, the types of securities traded, the outsourcing of operations of the ATS to other entities, the procedures governing the entry of orders, the means of access to the ATS, and procedures governing execution and reporting. Regarding amendments to an existing Form ATS, Rule 301(b)(2)(ii) of Regulation ATS<sup>584</sup> requires an ATS to file amendments to its current Form ATS at least 20 calendar days prior to implementing a material change to its operations. Rule 301(b)(2)(iii) of Regulation ATS<sup>585</sup> requires an ATS to file amendments to its current Form ATS within 30 calendar days after the end of each calendar quarter if any information contained in its initial operation report becomes inaccurate and has not been previously reported to the Commission.<sup>586</sup> Regarding shutting down an ATS, Rule 301(b)(2)(v) of Regulation ATS<sup>587</sup> requires an ATS to promptly file a cessation of operation report on current Form ATS upon ceasing operations as an ATS.

The Commission's currently approved estimate for an initial operation report on current Form ATS is 20 hours to gather the necessary information, provide the required disclosures in

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<sup>583</sup> 17 CFR 242.301(b)(2)(i).

<sup>584</sup> 17 CFR 242.301(b)(2)(ii).

<sup>585</sup> 17 CFR 242.301(b)(2)(iii).

<sup>586</sup> In addition, Rule 301(b)(2)(iv) requires an ATS to promptly file an amendment on current Form ATS after the discovery that any information previously filed on current Form ATS was inaccurate when filed. 17 CFR 242.301(b)(2)(iv).

<sup>587</sup> 17 CFR 242.301(b)(2)(v).

Exhibits A through I, and submit the Form ATS to the Commission.<sup>588</sup> With respect to Form ATS amendments, the Commission understands, based on the review of Form ATS amendments by the Commission and its staff, that ATSS that trade NMS stocks typically amend their Form ATS on average twice per year.<sup>589</sup> The frequency and scope of Form ATS amendments vary depending on whether the ATS is implementing a material change or a periodic change. Some ATSS may not change the manner in which they operate or anything else that might require an amendment to Form ATS in a given year while others may implement a number of changes during a given year that require Form ATS amendments. The Commission estimates that the current average compliance burden for each amendment to Form ATS is approximately 6 hours.<sup>590</sup> Accordingly, the estimated average annual ongoing burden of updating and amending Form ATS is approximately 12 hours per NMS Stock ATS.<sup>591</sup> With respect to ceasing operations, the currently approved average estimated compliance burden for an ATS to complete a cessation of operations report is 2 hours to check the appropriate box on Form ATS and send the cessation of operations report to the Commission.<sup>592</sup> The Commission's currently approved estimate for the average compliance burden for each Form ATS-R filing is 4 hours.<sup>593</sup>

**b. Burdens**

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<sup>588</sup> Attorney at 13 hours + Compliance Clerk at 7 hours = 20 burden hours. See Rule 301 PRA Update, supra note 575, 79 FR 6237.

<sup>589</sup> See id.

<sup>590</sup> Attorney at 4.5 hours + Compliance Clerk at 1.5 hours = 6 burden hours. See id.

<sup>591</sup> 2 Form ATS Amendments filed annually x 6 burden hours per Form ATS Amendment = 12 burden hours per ATS.

<sup>592</sup> Attorney at 1.5 hours + Compliance Clerk at 0.5 hours = 2 burden hours. See id.

<sup>593</sup> Attorney at 3 hours + Compliance Clerk at 1 hour = 4 burden hours. See id.

The Commission recognizes that proposed Rules 301(b)(2)(viii) and 304 of Regulation ATS, including proposed Form ATS-N, would impose certain burdens on respondents.<sup>594</sup>

Although the Commission preliminarily believes that many of the disclosures required by proposed Form ATS-N are currently required by Form ATS, proposed Form ATS-N would require an NMS Stock ATS to provide significantly more detail in those disclosures than currently is required by Form ATS. Proposed Form ATS-N would also require additional disclosures not currently mandated by current Form ATS such as those contained in Part III of proposed Form ATS-N. Under the proposed amendments to Regulation ATS, NMS Stock ATSs would be required to complete and file the enhanced and additional disclosures on proposed Form ATS-N.<sup>595</sup> Section XII.D.2.b.i below provides the estimated burden above the current Form ATS baseline of each item of proposed Form ATS-N. The Commission notes that many of the proposed disclosure items on proposed Form ATS-N are already required disclosures by respondents in whole or in part on current Form ATS, while other disclosure items on proposed Form ATS-N are novel (i.e., current Form ATS does not require some form of the proposed disclosure). Section XII.D.2.b.ii aggregates these new burdens and the additional burdens above the current Form ATS baseline that will be imposed by proposed Form ATS-N.

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<sup>594</sup> In establishing the estimates below with respect to proposed Form ATS-N, the Commission has considered its estimate of the burden for an SRO to amend a Form 19b-4. Specifically, the Commission estimated that 34 hours is the amount of time required to complete an average rule filing and 129 hours is the amount of time required to complete a complex rule filing, and three hours is the amount of time required to complete an average amendment to a rule filing. See Securities Exchange Act Release No. 50486 (October 4, 2004), 69 FR 60287 (October 8, 2004), 60294.

<sup>595</sup> These disclosures would be provided on proposed Form ATS-N and may have to be amended periodically as provided in proposed Rule 304.

**i. Analysis of Estimated Additional Burden for Proposed Form ATS-N**

Parts I and II of proposed Form ATS-N would require disclosure of certain general information regarding the broker-dealer operator and the NMS Stock ATS. Part I of proposed Form ATS-N would require the NMS Stock ATS to state the name of its broker-dealer operator, the name under which the NMS Stock ATS conducts business, if any, the MPID of the NMS Stock ATS, and whether it is an NMS Stock ATS operating pursuant to a previously filed initial operation report on Form ATS. Part II of proposed Form ATS-N would require the address of the physical location of the NMS Stock ATS matching system and the NMS Stock ATS's mailing address. Part II of proposed Form ATS-N would also require registration information of the broker-dealer operator, including its SEC File Number, the effective date of the broker-dealer operator's registration with the Commission, its CRD Number, the name of its national securities association, and the effective date of the broker-dealer operator's membership with the national securities association. In addition, Part II of proposed Form ATS-N would require disclosure of certain information regarding the legal status of the broker-dealer operator and would require the NMS Stock ATS to provide a URL address to its website. Finally, Part II would require the NMS Stock ATS to attach Exhibit 1 (a copy of any materials provided to subscribers or any other persons related to the operations of the NMS Stock ATS or the disclosures on Form ATS-N), Exhibit 2A (a copy of the most recently filed or amended Schedule A of the broker-dealer operator's Form BD disclosing information related to direct owners and executive officers), and Exhibit 2B (a copy of the most recently filed or amended Schedule B of the broker-dealer operator's Form BD disclosing information related to indirect owners). In lieu of attaching those exhibits to Form ATS-N, the NMS Stock ATSs would be able to provide a URL address to where the required documents can be found.

Under current Form ATS, an ATS is required to provide all of the information that would be required under Parts I and II of proposed Form ATS-N with the exception of: (1) its website address; (2) the effective date of the broker-dealer operator's registration with the Commission; (3) the name of the national securities association and effective date of the broker-dealer operator's membership with the national securities association; (4) the MPID of the NMS Stock ATS; (5) the broker-dealer operator's legal status (e.g., corporation or partnership); (6) the date of formation and the state in which the broker-dealer operator was formed; and (7) copies of the broker-dealer operator's most recently filed or amended Schedules A and B of Form BD.<sup>596</sup>

Current Form ATS, however, requires an ATS to provide a copy of its governing documents, such as its constitution and bylaws,<sup>597</sup> which would not be required in proposed Form ATS-N. The Commission preliminarily believes that all ATSs currently have access to all of these items because such information is germane to the operation of its broker-dealer operator. Accordingly, the Commission preliminarily estimates that, on average, preparing Parts I and II for a Form ATS-N would add 0.5 hours to the current baseline for an initial operation report on current Form ATS. The aggregate initial burden on all NMS Stock ATSs to complete Parts I and II of proposed Form ATS-N would be 23 hours above the current baseline.<sup>598</sup>

Part III, Item 1 of proposed Form ATS-N would require an NMS Stock ATS to disclose whether or not the broker-dealer operator or any of its affiliates operate or control any non-ATS

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<sup>596</sup> Exhibit I of Current Form ATS requires ATS to provide a list with the full legal name of those direct owners reported on Schedule A of Form BD, but not a copy of Schedule A.

<sup>597</sup> Exhibit D of Form ATS requires an ATS to provide a copy of its constitution, articles of incorporation or association, with all amendments, and of the existing bylaws or corresponding rules or instruments, whatever the name.

<sup>598</sup> Compliance Clerk at 0.5 hours x 46 NMS Stock ATSs = 23 burden hours.

trading center(s) that is an OTC market maker or executes orders in NMS stocks internally by trading as principal or crossing orders as agent (“non-ATS trading centers”), and if so, to (1) identify the non-ATS trading center(s); and (2) describe any interaction or coordination between the identified non-ATS trading center(s) and the NMS Stock ATS including: (i) circumstances under which subscriber orders or other trading interest received by the broker-dealer operator or its affiliates may execute, in whole or in part, in the identified non-ATS trading center before entering the NMS Stock ATS; (ii) circumstances under which subscriber orders or other trading interest sent to the NMS Stock ATS are displayed or otherwise made known to the identified non-ATS trading center(s) before entering the NMS Stock ATS; and (iii) circumstances under which orders or other trading interest are removed from the NMS ATS and sent to the identified non-ATS trading center(s). Under Proposed Form ATS-N, affiliates of the broker-dealer operator would only include any person that, directly or indirectly, controls, is under common control with, or is controlled by, the broker-dealer operator. The affiliates of the broker-dealer operator that might operate non-ATS trading centers under this proposal would thus be “control affiliates” that are either controlled by the broker-dealer operator or under common control with another entity. Consequently, because the broker-dealer operator would control all affiliates or would be under common control with those affiliates, the broker-dealer operator should be aware of whether its affiliates operate a non-ATS trading center or in most instances, should otherwise be able to readily obtain such information from its affiliates.<sup>599</sup>

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<sup>599</sup> To the extent the broker-dealer operator is currently unaware of whether its affiliates operate a non-ATS trading center, the Commission preliminarily believes that the broker-dealer operator could readily obtain this information from its affiliates.

To the extent the operation of a non-ATS trading center operated or controlled by the broker-dealer operator or any of its affiliates does not interact with the NMS Stock ATS (e.g., the two platforms do not share order flow or route trading interest between one another), the proposed disclosure requirement in Part III, Item 1, would require only that the NMS Stock ATS identify the non-ATS trading center in Item 1(a) and note that there is no interaction between the non-ATS trading center and the NMS Stock ATS in Item 1(b). To the extent the operation of a non-ATS trading center of the broker-dealer operator or its affiliates interacts with the NMS Stock ATS, the Commission preliminarily believes that the NMS Stock ATS would likely already be aware of how such operation may interact with the NMS Stock ATS. If there is substantial interaction between the non-ATS trading center and the NMS Stock ATS, the burden related to this disclosure would be higher.

The Commission understands that most, but not all, broker-dealer operators of NMS Stock ATSS currently, either by themselves or through their affiliates, operate or control a non-ATS trading center. The Commission preliminarily estimates that, on average, preparing Part III, Item 1 for a Form ATS-N would add 10 hours to the current baseline for an initial operation report on current Form ATS. This would result in an aggregate initial burden of 460 hours above the baseline for all NMS Stock ATSS to complete Part III, Item 1 of proposed Form ATS-N.<sup>600</sup>

Part III, Item 2 of proposed Form ATS-N would require an NMS Stock ATS to state whether the broker-dealer operator, or any of its affiliates, operates one or more NMS Stock ATSS other than the NMS Stock ATS named on the Form ATS-N, and, if so, to (1) identify the NMS Stock ATS(s) and provide its MPID(s); and (2) describe any interaction or coordination

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<sup>600</sup> (Attorney at 8 hours + Compliance Manager at 2 hours) x 46 NMS Stock ATSS = 460 burden hours.

between the NMS Stock ATS(s) identified and the NMS Stock ATS named on the Form ATS-N including: (i) the circumstances under which subscriber orders or other trading interest received by the broker-dealer operator or any of its affiliates to be sent to the NMS Stock ATS named in the Form ATS-N may be sent to any identified NMS Stock ATS(s); (ii) circumstances under which subscriber orders or other trading interest to be sent to the NMS Stock ATS named on the Form ATS-N are displayed or otherwise made known in any other identified NMS Stock ATS(s); and (iii) the circumstances under which a subscriber order received by the NMS Stock ATS named on the Form ATS-N may be removed and sent to any other identified NMS Stock ATS(s). Broker-dealer operators of multiple NMS Stock ATSs would already be aware of how their NMS Stock ATSs may interact with one another and those of its affiliates by, for example, sharing order flow between each other.<sup>601</sup> Further, as noted above, affiliates under this proposed disclosure requirement would be control affiliates that are either controlled by the broker-dealer operator or under common control with another entity. Consequently, the NMS Stock ATS should already be aware through its control or common control of whether its affiliates operate another NMS Stock ATS.

Based on the currently filed Forms ATS reviewed by the Commission during the third quarter of 2015, the Commission estimates that there are 6 broker-dealer operators that operate, by themselves or through an affiliate, multiple ATSs that trade NMS stocks. The Commission notes that broker-dealer operators operating multiple NMS Stock ATSs, by themselves or with their affiliates, would be required to complete Part III, Item 2 of proposed Form ATS-N for each

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<sup>601</sup> To the extent the broker-dealer operator or its affiliates operate multiple NMS Stock ATSs but there is no possibility of interaction between such NMS Stock ATSs, proposed Form ATS-N would only require that this fact be noted in Part III, Item 2(b).

NMS Stock ATS. The Commission preliminarily believes that it would not be a significant burden for a broker-dealer operator to identify all of the NMS Stock ATSs operated by either itself or its affiliates because, among other reasons, FINRA maintains an updated list of ATSs that trade equity securities on its public website.<sup>602</sup> Furthermore, the disclosure requirement in Part III, Item 2(b) to describe the interaction of the various NMS Stock ATSs should generally be the same for each NMS Stock ATS, reducing the overall hour burden for completing multiple Forms ATS-N.<sup>603</sup> The Commission also notes that the disclosure requirement in Part III, Item 2 would not impose any significant burden on broker-dealer operators that, by themselves or with their affiliates, do not operate multiple NMS Stock ATSs. For broker-dealer operators operating multiple NMS Stock ATSs, by themselves or with their affiliates, the Commission preliminarily estimates that, on average, preparing Part III, Item 2 for a Form ATS-N would add 4 hours to the current baseline for an initial operation report on current Form ATS. This would result in an aggregate initial hourly burden on such broker-dealer operators of 24 hours above the current baseline.<sup>604</sup>

Part III, Item 3 of proposed Form ATS-N would require an NMS Stock ATS to disclose whether or not the broker-dealer operator or any of its affiliates offer subscribers of the NMS

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<sup>602</sup> See FINRA Equity ATS Firm List, available at <https://www.finra.org/file/finra-equity-ats-firms-list>.

<sup>603</sup> In other words, a broker-dealer operator that operates NMS Stock ATSs “A” and “B” would likely be able to use the disclosure in A’s Form ATS-N for Part III, Item 2 for B as well.

<sup>604</sup> As noted above, the Commission estimates that there are currently approximately 6 broker-dealer operators that operate, by themselves or through an affiliate, multiple ATSs that trade NMS stocks. As such the increased burden would be calculated as follows: 6 operators of multiple NMS Stock ATSs x (Attorney at 2 hours + Senior Systems Analyst 2 hours) = 24 burden hours.

Stock ATS any products or services used in connection with trading on the NMS Stock ATS (e.g., algorithmic trading products, market data feeds). If so, the NMS Stock ATS would be required to describe the products and services and identify the types of subscribers (e.g., retail, institutional, professional) to which such services or products are offered, and if the terms and conditions of the services or products are not the same for all subscribers, describe any differences. These products and services may vary widely across NMS Stock ATSs, some of which may offer no additional products or services in connection with access to the NMS Stock ATS and others that may offer a wide array of other products or services such as trading algorithms, order management systems, or market data services. Because the broker-dealer operator controls all aspects of the NMS Stock ATS, it should already be aware of all the products and services that it or its affiliates provide to subscribers in connection with subscribers' access to the ATS. Accordingly, the Commission preliminarily believes that listing and describing these products and services in Part III, Item 3 would not impose a substantial burden on respondents. In addition, Part III, Item 3 would also require the NMS Stock ATS to describe which products and services are offered to which type of subscriber and any differences in the terms or conditions of the services or products among subscribers. Depending on the extent to which the terms and conditions of the services or products vary among subscribers, the hourly burden related to completing Part III, Item 3 would likely vary. The Commission preliminarily estimates that, on average, preparing Part III, Item 3 for a Form ATS-N would add 3 hours to the current baseline for an initial operation report on current Form ATS. This would

result in an aggregate initial burden of 138 hours above the current baseline for all NMS Stock ATSS to complete Part III, Item 3 of proposed Form ATS-N.<sup>605</sup>

Part III, Item 4 of proposed Form ATS-N would require an NMS Stock ATS to disclose whether or not the broker-dealer operator or any of its affiliates have any formal or informal arrangement with an unaffiliated person(s), or affiliate(s) of such person, that operates a trading center regarding access to the NMS Stock ATS, including preferential routing arrangements, and, if so, to identify the person(s) and the trading center(s) and describe the terms of the arrangement(s). The Commission understands from discussions with ATSS that some ATSS that currently trade NMS stock have arrangements with other ATSS to provide mutual access to the each other's respective ATSS. The Commission recognizes that an NMS Stock ATS could also have arrangements with other trading centers such as a non-ATS trading center or a national securities exchange. In addition, there may be NMS Stock ATSS that have no arrangements with any other trading center. As the broker-dealer operator controls all aspects of the operation of the NMS Stock ATS, the broker-dealer operator should already be aware of any such arrangements providing for mutual access or preferential routing that it has with other trading centers. Accordingly, the Commission preliminarily estimates that, on average, preparing Part III, Item 4 for a Form ATS-N would add 4 hours to the current baseline for an initial operation report on current Form ATS. This would result in an aggregate initial burden of 184 hours above

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<sup>605</sup> (Compliance Manager at 2 hours + Senior Marketing Manager at 1 hour) x 46 NMS Stock ATSS = 138 burden hours.

the current baseline for all NMS Stock ATSs to complete Part III, Item 4 of proposed Form ATS-N.<sup>606</sup>

Part III, Item 5 of proposed Form ATS-N would require certain disclosures related to the trading activity of the broker-dealer operator or its affiliates on the NMS Stock ATS.

Specifically, Part III, Item 5 would require the NMS Stock ATS to disclose whether or not the broker-dealer operator or any of its affiliates enters orders or other trading interest on the NMS Stock ATS, and, if so, to provide detailed disclosures describing such trading activity.<sup>607</sup> As the broker-dealer operator controls all aspects of the operation of the NMS Stock ATS, the broker-dealer operator should already know all of the subscribers to the NMS Stock ATS, including any affiliates that trade on the ATS, whether the broker-dealer operator itself trades on the NMS Stock ATS, and how the broker-dealer operator or its affiliates trade on the NMS Stock ATS.<sup>608</sup>

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<sup>606</sup> (Attorney at 2 hours + Compliance Manager at 2 hours) x 46 NMS Stock ATSs = 184 burden hours.

<sup>607</sup> Specifically, the NMS Stock ATS would be required to: (a) identify each affiliate and business unit of the broker-dealer operator that may enter orders or other trading interest on the NMS Stock ATS; (b) describe the circumstances and capacity in which each identified affiliate and business unit enters orders or trading interest on the NMS Stock ATS (e.g., proprietary or agency); (c) describe the means by which each identified affiliate and business unit enters orders or other trading interest on the NMS Stock ATS (e.g., directly through a FIX connection to the NMS Stock ATS, or indirectly, by way of the broker-dealer operator's SOR (or similar functionality), algorithm, intermediate application, or sales desk); and (d) describe any means by which a subscriber can be excluded from interacting or trading with orders or other trading interest of the broker-dealer operator or its affiliates on the NMS Stock ATS.

<sup>608</sup> There may be some NMS Stock ATSs for which neither the broker-dealer operator nor its affiliates trade on the NMS Stock ATS at all, and thus, for which the disclosures required under Part III, Item 5 would impose no significant burden. However, based on the review of Forms ATS by the Commission and its staff and discussions with broker-dealer operators, the Commission understands that a majority of ATSs that trade NMS stocks currently either trade in their own ATSs, either by themselves or with or through their affiliates.

The Commission preliminarily believes that this knowledge should allow NMS Stock ATSs to readily identify and list all affiliates that trade on the NMS Stock ATS pursuant to Part III, Item 5(a) without a significant burden. The broker-dealer operator may have to inquire as to the capacity in which each of its affiliates trade, the means by which they enter orders or other trading interest to the ATS, and any means by which a subscriber can be excluded from interacting with the orders or other trading interest of the broker-dealer operator or its affiliates pursuant to Items 5(b), (c), and (d). However, as previously noted, because the disclosure requirements with respect to affiliates would only apply to control affiliates, which would either be controlled by the broker-dealer operator or under common control with the broker-dealer operator, the broker-dealer operator may already have this information or would likely be able to obtain the information required under Items 5(b) and (c) without a significant burden.

Accordingly, the Commission preliminarily estimates that, on average, preparing Part III, Item 5 for a Form ATS-N would add 5 hours to the current baseline for an initial operation report on current Form ATS. This would result in an aggregate initial burden of 230 hours above the current baseline for all NMS Stock ATSs to complete Part III, Item 5 of proposed Form ATS-N.<sup>609</sup>

Part III, Item 6 of proposed Form ATS-N would require an NMS Stock ATS to disclose whether the broker-dealer operator, or any of its affiliates, use a SOR(s) (or similar functionality), an algorithm(s), or both to send or receive subscriber orders or other trading

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<sup>609</sup> (Attorney at 2 hours + Compliance Manager at 3 hours) x 46 NMS Stock ATSs = 230 burden hours.

interest to or from the NMS Stock ATS.<sup>610</sup> The Commission and its staff understand from conversations with ATSs that nearly every ATS that trades NMS stocks currently uses some form of SOR (or similar functionality) or algorithm. The Commission recognizes that the SOR(s) (or similar functionality) of the broker-dealer operator or its affiliates and any algorithm(s) employed by the broker-dealer operator or its affiliates to enter orders onto the NMS Stock ATS may vary widely among ATSs with respect to the manner in which they operate, the information they send or receive, and how the SOR(s) (or similar functionality) and/or algorithm(s) may determine to route certain orders to the NMS Stock ATS as opposed to other venues. Accordingly, the Commission preliminarily believes that the burdens associated with the disclosures in Part III, Item 6 of proposed Form ATS-N are likely to vary depending on the complexity of the SOR(s) (or similar functionality) and/or algorithm(s), its significance to the operation of the NMS Stock ATS, and the functions and roles that it performs.

For example, in responding to Part III, Item 6(b), which would require an NMS Stock ATS to describe, among other things, any information or messages about orders or other trading interest that the SOR(s) (or similar functionality) and algorithm(s) send or receive to or from the NMS Stock ATS, an NMS Stock ATS that uses IOIs to facilitate trades on the NMS Stock ATS and that uses its SOR(s) (or similar functionality) and/or algorithm(s) to facilitate the sending of those IOIs to relevant persons would likely have a substantially greater burden in responding to

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<sup>610</sup> Specifically, Part III, Item 6 of proposed Form ATS-N would require the NMS Stock ATS to: (a) identify the SOR(s) (or similar functionality) or algorithm(s) and identify the person(s) that operates the SOR(s) (or similar functionality) or algorithm(s), if other than the broker-dealer operator; and (b) describe the interaction or coordination between the identified SOR(s) (or similar functionality) or algorithm(s), including any information or messages about orders or other trading interest (e.g., IOIs) that the SOR(s) (or similar functionality) or algorithm(s) send or receive to or from the NMS Stock ATS and the circumstances under which such information may be shared with any person.

Item 6(b) due to the number of messages that may be associated with an IOI and the subsequent responses to that IOI than an NMS Stock ATS that does not use IOIs. Accordingly, the Commission preliminarily estimates that, on average, preparing Part III, Item 6 for a Form ATS-N would add 10 hours to the current baseline for an initial operation report on current Form ATS. This would result in an aggregate initial burden of 460 hours above the current baseline for all NMS Stock ATSs to complete Part III, Item 6 of proposed Form ATS-N.<sup>611</sup>

Part III, Item 7 of proposed Form ATS-N would require an NMS Stock ATS to disclose whether it has any shared employees,<sup>612</sup> and identify the business unit(s) and/or the affiliate(s) of the broker-dealer operator to which the shared employee(s) provides services and identify the position(s) or title(s) that the shared employee(s) holds in the business unit(s) and/or affiliate(s) of the broker-dealer operator; and (2) describe the roles and responsibilities of the shared employee(s) at the NMS Stock ATS and the business unit(s) and/or affiliate(s) of the broker-dealer operator. As the broker-dealer operator controls all aspects of the NMS Stock ATS, it should already be aware of all of its employees and likely aware of any other roles or functions that such employees provide to other business units or affiliates of the broker-dealer operator. The Commission therefore preliminarily believes that the NMS Stock ATS should be able to obtain this information readily. The extent of this disclosure burden would likely vary depending on the number of employees of the NMS Stock ATS and the extent to which such employees' roles are solely dedicated to operating the NMS Stock ATS versus also servicing

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<sup>611</sup> (Attorney at 4 hours + Compliance Manager at 3 hours + Sr. Systems Analyst at 3 hours) x 46 NMS Stock ATSs = 460 burden hours.

<sup>612</sup> See supra Section VII.B.8 describing who would be considered a shared employee of the broker-dealer operator.

other business unit(s) of the broker-dealer operator or its affiliates. Accordingly, the Commission preliminarily estimates that, on average, preparing Part III, Item 7 for a Form ATS-N would add 4 hours to the current baseline for an initial operation report on current Form ATS. This would result in an aggregate initial burden of 184 hours above the current baseline for all NMS Stock ATSs to complete Part III, Item 7 of proposed Form ATS-N.<sup>613</sup>

Part III, Item 8 of proposed Form ATS-N would require an NMS Stock ATS to disclose whether any operation, service, or function of the NMS Stock ATS is performed by any person(s) other than the broker-dealer operator of the NMS Stock ATS, and if so to: (1) identify the person(s) (in the case of a natural person, to identify only the person's position or title) performing the operation, service, or function and note whether this service provider(s) is an affiliate of the broker-dealer, if applicable; (2) describe the operation, service, or function that the identified person(s) provides and describe the role and responsibilities of that person(s); and (3) state whether the identified person(s), or any of its affiliates, may enter orders or other trading interest on the NMS Stock ATS and, if so, describe the circumstances and means by which such orders or other trading interest are entered on the NMS Stock ATS. The Commission notes that this proposed disclosure requirement is similar to the Exhibit E disclosure requirement under the current Form ATS.<sup>614</sup> The only additional disclosure requirement beyond that required currently by Exhibit E to Form ATS would be Item 8(c), which would require the NMS Stock ATS to state

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<sup>613</sup> (Attorney at 2 hours + Compliance Manager at 2 hours) x 46 NMS Stock ATSs = 184 burden hours.

<sup>614</sup> Exhibit E of Form ATS requires an ATS to provide the name of any entity, other than the ATS, that is involved in the operation of the ATS, including the execution, trading, clearing, and settling of transactions on behalf of the ATS, and to provide a description of the role and responsibilities of each entity.

whether or not the service provider or the service provider's affiliate may transact on the NMS Stock ATS, and if so, the circumstances and means by which they may do so. The Commission preliminarily believes based on its review of Form ATS Exhibit E disclosures that most, but not all, service providers to ATSs are not typically entities that would transact on the ATS by themselves. Based on Commission experience, affiliates of service providers to some ATSs that transact in NMS stock may subscribe to that ATS. An NMS Stock ATS may have to ask the service provider about the nature of the service provider's affiliates to ensure that such affiliates are not subscribers to the NMS Stock ATS or may otherwise be able to transact on the NMS Stock ATS to complete this disclosure. Accordingly, the Commission preliminarily estimates that, on average, preparing Part III, Item 8 for a Form ATS-N would add 3 hours to the current baseline for an initial operation report on current Form ATS. This would result in an aggregate initial burden of 138 hours above the baseline for all NMS Stock ATSs to complete Part III, Item 8 of proposed Form ATS-N.<sup>615</sup>

Part III, Item 9 of proposed Form ATS-N would require an NMS Stock ATS to identify and describe any service, functionality, or procedure of the NMS Stock ATS available to the broker-dealer operator or its affiliates that is not available or does not apply to a subscriber(s) to the NMS Stock ATS. The Commission is not currently aware of any NMS Stock ATS that provides services, functionalities, or procedures to itself or its affiliates and not to subscribers, although the Commission recognizes that an NMS Stock ATS could do so. To the extent that the services, functionalities, or procedures of the NMS Stock ATS provided to the broker-dealer operator or its affiliates on the NMS Stock ATS differ from those provided to non-affiliated

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<sup>615</sup> (Attorney at 1 hour + Compliance Manager at 2 hours) x 46 NMS Stock ATSs = 138 burden hours.

subscribers, the NMS Stock ATS would have to describe all such differences in Item 9. Depending on the extent of such differences, the hourly burden for providing these disclosures would vary. Conversely, if there are no differences between the services, functionalities, or procedures of the NMS Stock ATS that are provided to the broker-dealer operator or its affiliates relative to subscribers, Part III, Item 9 would only require the NMS Stock ATS to note this fact. Accordingly, the Commission preliminarily estimates that, on average, preparing Part III, Item 9 for a Form ATS-N would add 2 hours to the current baseline for an initial operation report on current Form ATS. This would result in an aggregate initial burden of 92 hours above the current baseline for all NMS Stock ATSs to complete Part III, Item 9 of proposed Form ATS-N.<sup>616</sup>

Part III, Item 10 of proposed Form ATS-N would require certain disclosures related to the NMS Stock ATS's written safeguards and written procedures to protect the confidential trading information of subscribers pursuant to Rule 301(b)(10) of Regulation ATS.<sup>617</sup> As previously discussed, NMS Stock ATSs would be required under the proposed amendments to Regulation ATS to write their policies and procedures under Rule 301(b)(10) of Regulation ATS. Part III, Item 10 of proposed Form ATS-N would require a description of these policies and procedures. Because NMS Stock ATSs would have already incurred an hourly burden in

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<sup>616</sup> (Attorney at 1.5 hours + Compliance Manager at 0.5 hour) x 46 NMS Stock ATSs = 92 burden hours.

<sup>617</sup> Specifically, an NMS Stock ATS would be required to: (1) describe the means by which a subscriber may consent or withdraw consent to the disclosure of confidential trading information to any persons (including the broker-dealer operator and any of its affiliates); (2) identify the positions or titles of any persons that have access to confidential trading information, describe the confidential trading information to which the persons have access, and describe the circumstances under which the persons can access confidential trading information; (3) describe the written standards controlling employees of the NMS Stock ATS that trade for employees' accounts; and (4) describe the written oversight procedures to ensure that the safeguards and procedures are implemented and followed.

connection with writing its policies and procedures pursuant to Rule 301(b)(10) of Regulation ATS, the Commission preliminarily believes that Item 10 would impose only a minimal burden on NMS Stock ATSs to describe such written policies and procedures. Part III, Item 10(b) of proposed Form ATS-N would also require an NMS Stock ATS to identify the positions or titles of any persons that can access the confidential trading information of subscribers, a description of what information such persons can access, and the circumstances under which such persons can access the confidential trading information. The Commission preliminarily believes that NMS Stock ATSs should, pursuant to their existing obligations under Rule 301(b)(10), be aware of all persons that can access the confidential trading information of subscribers, the circumstances under which such persons can access that information, and what information they can access. As NMS Stock ATSs should already have this knowledge, the Commission preliminarily believes that the proposed disclosures of Item 10(b) would not be overly burdensome for an NMS Stock ATS to complete. Accordingly, the Commission preliminarily estimates that, on average, preparing Part III, Item 10 for a proposed Form ATS-N would add 2 hours above the current baseline for an initial operation report on current Form ATS. This would result in an aggregate initial burden of 92 hours above the current baseline for all NMS Stock ATSs to complete Item 10 of Part III of proposed Form ATS-N.<sup>618</sup>

Part IV, Item 1 of proposed Form ATS-N would require an NMS Stock ATS to disclose, among other things, information regarding: (1) any eligibility requirements to access the NMS Stock ATS; (2) the terms and conditions of any contractual agreements for granting access to the NMS Stock ATS for the purpose of effecting transactions in securities or for submitting,

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<sup>618</sup> (Attorney at 1 hour + Compliance Manager at 1 hour) x 46 NMS Stock ATSs = 92 burden hours.

disseminating, or displaying orders on the NMS Stock ATS; (3) the types of subscribers and other persons that use the services of the NMS Stock ATS; (4) any formal or informal arrangement the NMS Stock ATS has with liquidity providers; and (5) any circumstances by which access to the NMS Stock ATS can be limited or denied and the procedures or standards that are used to determine such action. For each disclosure, the NMS Stock ATS would also be required to explain whether there are any differences in how these requirements, terms, conditions, criteria, procedures, and/or standards are applied among subscribers and persons.

The Commission notes that the proposed disclosure requirements of Part IV, Item 1 of proposed Form ATS-N are, in large part, already required under current Form ATS. Exhibit A of current Form ATS requires an ATS to describe its classes of subscribers (e.g., broker-dealer, institutional, or retail) and any differences in access to services offered by the ATS to different groups or classes of subscribers. Part IV, Item 1 of proposed Form ATS-N requires the disclosure of similar information to Exhibit A, but Part IV, Item 1 would expressly require significantly more detail, and a greater number of disclosures, than Exhibit A of current Form ATS including with respect to the terms and conditions of use and eligibility to become a subscriber. The Commission notes that ATSs currently vary in the depth of their discussion of subscribers in Exhibit A of their Forms ATS, with some providing a fulsome description that would likely include most of the express disclosures proposed under Part IV, Item 1 of proposed Form ATS-N, while other ATSs might not, for example, provide details surrounding differing eligibility requirements among subscribers.

Depending on the complexity of the NMS Stock ATS, the different types of subscribers, and, most significantly, the extent to which the terms and conditions vary among subscribers, the disclosure burden related to Part IV, Item I of proposed Form ATS-N would likely vary. For

example, an NMS Stock ATS with two classes of subscribers with identical terms and conditions of use, eligibility criteria, and the same circumstances and process regarding limiting and denying services of the NMS Stock ATS would likely have less of a burden than an NMS Stock ATS with five groups of subscribers with varying terms and conditions of use, eligibility criteria, and differing circumstances and processes for which they may be limited or denied the services of the NMS Stock ATS. Accordingly, the Commission preliminarily estimates that, on average, preparing Part IV, Item 1 of a Form ATS-N would add 6 hours to the current baseline for an initial operation report on current Form ATS to respond to the more detailed questions regarding subscribers to the NMS Stock ATS. This would result in an aggregate initial burden of 276 hours above the current baseline for all NMS Stock ATSs to complete Part IV, Item 1 of proposed Form ATS-N.<sup>619</sup>

Part IV, Item 2 of proposed Form ATS-N would require an NMS Stock ATS to provide the days and hours of operation of the NMS Stock ATS, including the times when orders or other trading interest are entered on to the NMS Stock ATS and the time when pre-opening or after-hours trading may occur. It would also require the NMS Stock ATS to explain differences, if any, among subscribers and persons in the times when orders or other trading interest are entered on the NMS Stock ATS. Current Form ATS does not specify similar disclosures, so the Commission preliminarily estimates that respondents would incur additional burdens above the current baseline when preparing the disclosures required under Part IV, Item 2 of proposed Form ATS-N. The NMS Stock ATS should already be aware of the hours during which it operates and whether and when it permits pre-opening or after-hours trading. Based on the experience of the

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<sup>619</sup> (Attorney at 4 hours + Compliance Manager at 2 hours) x 46 NMS Stock ATSs = 276 burden hours.

Commission and its staff reviewing Form ATS and ATS-R filings, the Commission preliminarily believes that most ATSs that currently trade NMS stocks do not provide for after-hours or pre-opening trading of NMS stock. For NMS Stock ATSs for which the times when orders or other trading interest may be sent to the NMS Stock ATS are not the same for all subscribers and persons, the disclosure burden related to Part IV, Item 2 would likely increase. Accordingly, the Commission preliminarily estimates that, on average, preparing Part IV, Item 2 for a Form ATS-N would add 0.5 hours to the current baseline for an initial operation report on current Form ATS. This would result in an aggregate initial burden of 23 hours above the current baseline for all NMS Stock ATSs to complete Part IV, Item 2 of proposed Form ATS-N.<sup>620</sup>

Part IV, Item 3 of proposed Form ATS would require an NMS Stock ATS to provide a detailed disclosure of the order types available on the NMS Stock ATS. Part IV Item 3(a) would require an NMS Stock ATS to describe any types of orders that are entered to the NMS Stock ATS, their characteristics, operations, and how they are handled on the NMS Stock ATS.<sup>621</sup> Part IV, Item 3(b) would require the NMS Stock ATS to describe any differences if the availability of its order types, and their terms and conditions, are not the same for all subscribers and persons. Part IV, Item 3(c) would require an NMS Stock ATS to describe any requirements and handling

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<sup>620</sup> Compliance Manager at 0.5 hours x 46 NMS Stock ATSs = 23 burden hours.

<sup>621</sup> This would include: (i) priority for each order type; (ii) conditions for each order type; (iii) order types designed not to remove liquidity (e.g., post-only orders); (iv) order types that adjust their price as changes to the order book occur (e.g., price sliding orders or pegged orders) or have a discretionary range; (v) the time-in-force instructions that can be used or not used with each order type; (vi) the availability of order types across all forms of connectivity to the NMS Stock ATS and differences, if any, between the availability of an order type across these forms of connectivity; (vii) whether an order type is eligible for routing to other trading centers; and (viii) the circumstances under which order types may be combined with a time-in-force or another order type, modified, replaced, canceled, rejected, or removed from the NMS Stock ATS.

procedures for minimum order sizes, odd-lot orders, and mixed-lot orders and to describe any differences if the requirements and handling procedures for minimum order sizes, odd-lot, or mixed-lot orders are not the same for all subscribers and persons. Part IV, Item 3(d) would require an NMS Stock ATS to describe any messages sent to or received by the NMS Stock ATS indicating trading interest (e.g., IOIs, actionable IOIs or conditional orders), including the information contained in the message, the means under which messages are transmitted, the circumstances in which messages are transmitted (e.g., automatically by the NMS Stock ATS, or upon the subscriber's request), and the circumstances in which they may result in an execution on the NMS Stock ATS; the NMS Stock ATS would also be required to describe any differences among subscribers and persons if the terms and conditions regarding these messages, IOIs, and conditional orders are not the same for all subscribers and persons.

The Commission notes that some of the proposed disclosure requirements of Part IV, Item 3 of proposed Form ATS-N are already required under current Form ATS. Exhibit F of current Form ATS requires an ATS to describe, among other things, the manner of operation and the procedures governing order entry and execution of the ATS. Part IV, Item 3 of proposed Form ATS-N would require significantly more detail, and a greater number of disclosures, in regard to types of orders than Exhibit F of current Form ATS. ATSs that trade NMS stocks currently vary in the extent of their disclosures relating to order types as provided in Exhibit F. Some provide a relatively fulsome discussion of different order types and to whom they are made available, while other ATSs that trade NMS stocks do not provide substantial detail in this area. Depending on the extent to which an ATS that trades NMS stocks already discloses most of the information regarding order types and trading interest on Exhibit F of its Form ATS, as well as the variety and complexity of different order types available, the proposed disclosure

burden of Part IV, Item 3 of proposed Form ATS-N will likely vary among NMS Stock ATSs. For example, those NMS Stock ATSs that send and receive actionable IOIs and/or conditional orders would be required to draft a detailed explanation regarding those order types for Part IV, Item 3(d), whereas NMS Stock ATSs without such order types would simply state that they do not send and receive IOIs and conditional orders. Accordingly, the Commission preliminarily estimates that, on average, preparing Part IV, Item 3 of a Form ATS-N would add 6 hours to the current baseline for an initial operation report on current Form ATS, depending on such factors as described above. This would result in an aggregate initial burden of 276 hours above the current baseline for an initial operation report on current Form ATS for all NMS Stock ATSs to complete Part IV, Item 3 of proposed Form ATS-N.<sup>622</sup>

Part IV, Item 4 of proposed Form ATS-N would require an NMS Stock ATS to disclose the means by which subscribers or other persons connect and send orders to the NMS Stock ATS. Part IV, Item 4(a) would require the NMS Stock ATS to describe the means by which subscribers or other persons connect to the NMS Stock ATS and enter orders or other trading interest on the NMS Stock ATS (e.g., via a direct FIX connection to the ATS or an indirect connection via the broker-dealer operator's SOR, any intermediate functionality, algorithm, or sales desk). This item would also require the NMS Stock ATS to describe any differences if the terms and conditions for connecting and entering orders or other trading interest are not the same for all subscribers and persons. Part IV, Item 4(b) would require the NMS Stock ATS to describe any co-location services or any other means by which any subscriber or other persons may enhance the speed by which to send or receive orders, trading interest, or messages to or

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<sup>622</sup> (Attorney at 1 hour + Compliance Manager at 2 hours + Sr. Systems Analyst at 3 hours) x 46 NMS Stock ATSs = 276 burden hours.

from the NMS Stock ATS, the terms and conditions of such co-location services, and to describe any differences if the terms and conditions of the co-location services are not the same for all subscribers and persons.

The Commission notes that some of the proposed disclosure requirements of Part IV, Item 4 of proposed Form ATS-N are already required under current Form ATS. Exhibit F of current Form ATS requires an ATS to describe, among other things, the means of access to the ATS. Part IV, Item 4 of proposed Form ATS-N would expressly require significantly more detail, and a greater number of disclosures, in regard to order entry, connectivity, and co-location services than Exhibit F of current Form ATS. ATSS that currently trade NMS stocks vary in the depth of their disclosures related to order entry. Currently, most ATSS that trade NMS stocks do not provide much or any detail regarding the extent to which they provide co-location services or other speed advantages to subscribers or persons trading on the ATS. Accordingly, the Commission preliminarily estimates that respondents would incur an additional burden above the current baseline when preparing the disclosures required under Part IV, Item 4 of proposed Form ATS-N. The Commission preliminarily estimates that, on average, preparing Part IV, Item 4 for a Form ATS-N would add 5 hours to the current baseline for an initial operation report on current Form ATS to provide a more detailed description of the connection and order entry procedures, a description of any co-location or speed-advantage services, as well as any differences among subscribers and other persons with respect to these disclosures. This would result in an aggregate

initial burden of 230 hours above the current baseline for all NMS Stock ATSs to complete Item 4 of Part IV of proposed Form ATS-N.<sup>623</sup>

Part IV, Item 5 of proposed Form ATS-N would require an NMS Stock ATS to explain if and how it segments order flow, the type of notice about such segmentation that it provides to subscribers, and whether subscribers, the broker-dealer operator, or its affiliates may submit order preferencing instructions. Part IV, Item 5(a) would require an NMS Stock ATS to describe any segmentation of orders or other trading interest on the NMS Stock ATS (e.g., classification by type of participant, source, nature of trading activity), and to describe the segmentation categories, the criteria used to segment these categories, and procedures for determining, evaluating, and changing segmented categories. This item would require an NMS Stock ATS to describe any differences if the segmented categories, the criteria used to segment these categories, and any procedures for determining, evaluating, or changing segmented categories are not the same for all subscriber and persons. Part IV, Item 5(b) would require the NMS Stock ATS to state whether it notifies subscribers or persons about the segmentation category that a subscriber or a person is assigned and to describe any notice provided to subscribers or persons about the segmented category that they are assigned and the segmentation identified in Item 5(a), including the content of any notice and the means by which any notice is communicated. If the notice is not the same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences. Part IV, Item 5(c) would require an NMS Stock ATS to describe any means and the circumstances by which a subscriber, the broker-dealer operator, or any of its affiliates may designate an order or trading interest submitted to the NMS Stock ATS to interact

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<sup>623</sup> (Attorney at 1 hour + Compliance Manager at 2 hours + Sr. Systems Analyst at 2 hours) x 46 NMS Stock ATSs = 230 burden hours.

or not to interact with specific orders, trading interest, or persons on the NMS Stock ATS (e.g., designating an order or trading interest to be executed against a specific subscriber) and how such designations affect order priority and interaction.

The Commission notes that some of the proposed disclosure requirements of Part IV, Item 5 of proposed Form ATS-N are already required under current Form ATS. Exhibit F of current Form ATS requires an ATS to describe, among other things, the manner of operation and the procedures governing order entry and execution of the ATS. However, Exhibit F of current Form ATS does not expressly enumerate the level of detail that an ATS must provide in regard to its segmentation of order flow and does not expressly ask for an ATS to describe any notice to subscribers regarding segmentation or explain any means and circumstances for order preferencing, whereas Part IV, Item 5 of proposed Form ATS-N would require detailed disclosures in regard to these subjects.<sup>624</sup> Based on its review of Exhibit F disclosures, the Commission understands that most, but not all, ATSs that currently trade NMS stocks segment orders in some manner and that many NMS Stock ATSs allow subscribers to enter some order preferencing criteria or limits. These ATSs vary in the depth of their description as to how they segment order flow and order preferencing. For instance, most ATSs that currently trade NMS stocks do not expressly provide the Commission with a description of the means by which persons might be notified about segmentation, as would be required by Part IV, Item 5(b) of proposed Form ATS-N. Accordingly, the Commission preliminarily estimates that respondents would incur an additional burden above the current baseline when preparing the disclosures

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<sup>624</sup> Though Exhibit F of current Form ATS, unlike Item 5(b) of Part IV of proposed Form ATS-N, does not expressly require ATSs to describe the content of any notice to subscribers regarding segmentation, Exhibit F does require a copy of any materials currently provided to subscribers, which could include such a notice.

required under Part IV, Item 5 of proposed Form ATS-N. The Commission preliminarily estimates that, on average, preparing Part IV, Item 5 for a Form ATS-N would add 7 hours to the current baseline for an initial operation report on current Form ATS to provide a detailed description of how, if at all, the NMS Stock ATS segments order flow, provides any notice to those trading on the NMS Stock ATS regarding segmentation, and allows order preferencing. This would result in an aggregate initial burden of 322 hours above the current baseline for all NMS Stock ATSs to complete Part IV, Item 5 of proposed Form ATS-N.<sup>625</sup>

Part IV, Item 6(a) of proposed Form ATS-N would require an NMS Stock ATS to describe any means and circumstances by which orders or other trading interest on the NMS Stock ATS are displayed or made known outside the NMS Stock ATS and the information about the orders and trading interest that are displayed. If the display of orders or other trading interest is not the same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences. Part IV, Item 6(b) of proposed Form ATS-N would require the NMS Stock ATS to identify the subscriber(s) or person(s) (in the case of a natural person, the NMS Stock ATS would only identify the person's position or title) to whom the orders and trading interest are displayed or otherwise made known. Although Exhibit F of current Form ATS requires an ATS to describe, among other things, the manner of operation and the procedures governing order entry and execution of the ATS, Exhibit F does not expressly state that an ATS must explain if and how order information is displayed or otherwise made known outside the NMS Stock ATS. The Commission understands from its review of Forms ATS filings that a majority of ATSs that trade NMS stocks provide some form of IOI or conditional order that

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<sup>625</sup> (Attorney at 2 hours + Compliance Manager at 2.5 hours + Sr. Systems Analyst at 2.5 hours) x 46 NMS Stock ATSs = 322 burden hours.

would likely need to be described in Part IV, Item 6 of proposed Form ATS-N.<sup>626</sup> Depending on the variety of trading interest that shares some trading information outside of the NMS Stock ATS and the complexity of such information sharing, the disclosure burden in responding to Part IV, Item 6 would likely vary among NMS Stock ATSs. The Commission also notes that there is currently one ATS that trades NMS stocks that operates as an ECN. This ATS would have to describe in Part IV, Item 6 how it displays orders and other information about trading interest on the ATS. Accordingly, the Commission preliminarily estimates that, on average, preparing Part IV, Item 6 for a Form ATS-N would add 5 hours to the current baseline for an initial operation report on current Form ATS, depending on such factors as described above. This would result in an aggregate initial burden of 230 hours above the current baseline for all NMS Stock ATSs to complete Part IV, Item 6 of proposed Form ATS-N.<sup>627</sup>

Part IV, Item 7 of proposed Form ATS-N would require an NMS Stock ATS to describe its trading services in detail. Part IV, Items 7(a) and 7(b) of proposed Form ATS-N would require an NMS Stock ATS to disclose the means or facilities used by the NMS Stock ATS to bring together the orders of multiple buyers and sellers, as well as the established, non-discretionary methods that dictate the terms of trading among multiple buyers and sellers on the facilities of the NMS Stock ATS, including rules and procedures governing the priority, pricing methodologies, allocation, matching, and execution of orders and other trading interest. Part IV, Item 7(c) would require the NMS Stock ATS to describe any trading procedures related to price protection mechanisms, short sales, locked-crossed markets, the handling of execution errors,

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<sup>626</sup> See *supra* Part IV, Item 6 of proposed Form ATS-N.

<sup>627</sup> (Attorney at 1 hour + Compliance Manager at 2 hours + Sr. Systems Analyst at 2 hours) x 46 NMS Stock ATSs = 230 burden hours.

time-stamping of orders and executions, or price improvement functionality. For all disclosures required under Item 7, the NMS Stock ATS would also be required to describe any differences in the availability of a functionality regarding its trading services among subscribers and persons.

The Commission notes that some of the proposed disclosure requirements of Part IV, Item 7 of proposed Form ATS-N are already required under current Form ATS. Exhibit F of current Form ATS requires an ATS to describe, among other things, the manner of operation and the procedures governing order entry and execution of the ATS. These required disclosures in Exhibit F of Form ATS are similar to those set forth in Item 7 of proposed Form ATS-N, which would require disclosures relating to matching methodology, order interaction rules, and execution procedures of the NMS Stock ATS. Consequently, the Commission preliminarily believes that NMS Stock ATSS already have some experience completing Exhibit F that would lessen the burden related to responding to the more detailed disclosures in Items 7(a), (b), and (c) of Part IV of proposed Form ATS-N.

Furthermore, Part IV, Item 7 of proposed Form ATS-N would require an NMS Stock ATS to describe how the NMS Stock ATS meets the two prongs necessary to meet the Exchange Act's definition of "exchange" pursuant to Rule 3b-16(a) under the Exchange Act in Items 7(a) and (b).<sup>628</sup> Based on reviews of Form ATS submissions, the Commission understands that ATSS that currently trade NMS stocks generally do not explicitly explain how their systems meet the requirements of each prong under Rule 3b-16, which are necessary in order to constitute an ATS.

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<sup>628</sup> See 17 CFR 240.3b-16 providing, among other things, that an entity must (1) bring together the orders for securities of multiple buyers and sellers; and (2) use established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade).

Those systems seeking to operate as NMS Stock ATSs would be required to draft those explanations, or modify existing descriptions of their current system as they may provide currently in Form ATS, to meet the disclosure requirements of Part IV, Item 7 of proposed Form ATS-N.

Accordingly, the Commission preliminarily estimates that respondents would incur an additional burden above the current baseline when preparing the disclosures required under Part IV, Item 7 of proposed Form ATS-N. The Commission preliminarily estimates that, on average, preparing Part IV, Item 7 for a Form ATS-N would add 6 hours to the current baseline for an initial operation report on current Form ATS to provide a description of the NMS Stock ATS's trading services. This would result in an aggregate initial burden of 276 hours above the current baseline for all NMS Stock ATSs to complete Part IV, Item 7 of proposed Form ATS-N.<sup>629</sup>

Part IV, Item 8 of proposed Form ATS-N would require an NMS Stock ATS to describe any procedures governing trading in the event the NMS Stock ATS suspends trading or experiences a system disruption or system malfunction. If the procedures governing trading during a suspension or system disruption or malfunction are not the same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences.

Exhibit G of Form ATS requires ATSs to describe the ATS's procedures for reviewing system capacity, security, and contingency planning procedures. The Commission preliminarily believes that the proposed disclosures in Part IV, Item 8 of proposed Form ATS-N relating to system disruptions, malfunctions, or other suspensions relate, in part, to the Exhibit G disclosures on current Form ATS. The Commission notes that some ATSs that trade NMS

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<sup>629</sup> (Attorney at 1 hour + Compliance Manager at 2 hours + Sr. Systems Analyst at 3 hours)  
x 46 NMS Stock ATSs = 276 burden hours.

stocks currently provide some disclosures relating to system disruptions, malfunctions, and other suspensions in their Exhibit F, Exhibit G, or in subscriber manuals (or other materials provided to subscribers) that are required to be provided to the Commission under Exhibit F of current Form ATS. Consequently, the Commission preliminarily believes that NMS Stock ATSs should be able to provide the proposed disclosures in Part IV, Item 8 of proposed Form ATS-N without a significant burden over the current baseline as they should already be aware of how the ATS operates, handles system disruptions, malfunctions or other suspensions. The Commission recognizes, however, that Item Part IV, Item 8 is significantly more specific and detailed in its proposed disclosure requirements than current Form ATS.

Accordingly, the Commission preliminarily estimates that respondents would incur an additional burden above the current baseline when preparing the disclosures required under Part IV, Item 8 of proposed Form ATS-N. The Commission preliminarily estimates that, on average, preparing Part IV, Item 8 for a Form ATS-N would add 2.5 hours to the current baseline for an initial operation report on current Form ATS to provide a detailed description of the NMS Stock ATS's procedures for system disruptions, malfunctions, or other suspensions. This would result in an aggregate initial burden of 115 hours above the current baseline for all NMS Stock ATSs to complete Part IV, Item 8 of proposed Form ATS-N.<sup>630</sup>

Part IV, Item 9 of proposed Form ATS-N would require an NMS Stock ATS to describe any opening, reopening and closing processes, and any procedures for after-hours trading. Part IV, Item 9(a) of proposed Form ATS-N would require an NMS Stock ATS to describe any opening and reopening processes, including how orders or other trading interest are matched and

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<sup>630</sup> (Attorney at 1 hour + Compliance Manager at .5 hours + Sr. Systems Analyst at 1 hour) x 46 NMS Stock ATSs = 115 burden hours.

executed prior to the start of regular trading hours or following a stoppage of trading in a security during regular trading hours and how unexecuted orders or other trading interest are handled at the time the NMS Stock ATS begins regular trading at the start of regular trading hours or following a stoppage of trading in a security during regular trading hours. The NMS Stock ATS would also be required to describe any differences between pre-opening executions, executions following a stoppage of trading in a security during regular trading hours, and executions during regular trading hours. Part IV, Items 9(b) and (c) would require an NMS Stock ATS to describe any closing process and after-hours trading procedures, respectively, the manner in which unexecuted orders or other trading interest are handled at the close of regular trading, and how orders and trading interest are matched and executed during after-hours trading. The NMS Stock ATS would also be required to describe any differences between the closing and after-hours executions versus executions during regular trading hours.

The Commission notes that some of the proposed disclosure requirements of Part IV, Item 9 of proposed Form ATS-N are incorporated by some ATSs that trade NMS stocks into Exhibit F of their current Forms ATS, which requires an ATS to describe, among other things, the manner of operation and the procedures governing order entry and execution of the ATS. Currently, ATSs that trade NMS stocks vary in the depth of their disclosures relating to opening, reopening, or closing processes, and after-hours trading procedures. The Commission notes that these opening, reopening, or closing processes, and after-hours trading procedures, may vary widely across different NMS Stock ATSs, with some, for example, allowing for pre-opening executions and routing and after-hours trading and routing, while others may not have an opening process and simply commence with regular trading without any option for after-hours trading. In any case, NMS Stock ATSs should already be aware of any opening, reopening or

closing processes, and after-hours trading procedures, they may have as well as any differences in trading and execution during the opening, reopening, or closing processes, and during after-hours trading. Accordingly, the Commission preliminarily believes that preparing Part IV, Item 9 of proposed Form ATS-N for a Form ATS-N would not impose a significant additional burden above the current baseline for an initial operation report on current Form ATS. The Commission preliminarily estimates that, on average, preparing Part IV, Item 9 for a Form ATS-N would add 3 hours to the current baseline for an initial operation report on current Form ATS to describe its opening, reopening, or closing processes, and after-hours trading procedures. This would result in an aggregate initial burden of 138 hours above the current baseline for all NMS Stock ATSs to complete Part IV, Item 9 of proposed Form ATS-N.<sup>631</sup>

Part IV, Item 10 of proposed Form ATS-N would require an NMS Stock ATS to describe its outbound routing functions. Part IV, Item 10(a) of proposed Form ATS-N would require an NMS Stock ATS to describe the circumstances under which orders or other trading interest are routed from the NMS Stock ATS to another trading center, including whether outbound routing occurs at the affirmative instruction of the subscriber or at the discretion of the broker-dealer operator, and the means by which routing is performed (e.g., a third party or order management system, or a SOR (or similar functionality) or algorithm of the broker-dealer operator or any of its affiliates). Part IV, Item 10(b) of proposed Form ATS-N would require an NMS Stock ATS to describe any differences if the means by which orders or other trading interest are routed from the NMS Stock ATS are not the same for all subscribers and persons. Exhibit F of current Form ATS requires an ATS to describe, among other things, the manner of operation and the

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<sup>631</sup> (Compliance Manager at 2 hours + Sr. Systems Analyst at 1 hour) x 46 NMS Stock ATSs = 138 burden hours.

procedures governing order execution of the ATS, but it does not specifically state the level of detail an ATS must provide when describing its outbound routing procedures. Additionally, the Commission understands based on disclosures in Form ATS submissions, some ATSs that currently trade NMS stocks do not route orders out of the ATS. Consequently, the disclosure burden related to Part IV, Item 10 of proposed Form ATS-N would likely vary among NMS Stock ATSs depending on whether they route orders at all, the variety of circumstances under which they may route orders, and the variety of destinations or criteria to determine such destinations to which an order or other trading interest may route. Accordingly, the Commission preliminarily believes that the average additional burden above the baseline imposed by Part IV, Item 10 of proposed Form ATS-N may vary significantly among NMS Stock ATSs. Accordingly, the Commission preliminarily estimates that, on average, preparing Part IV, Item 10 for a Form ATS-N would add 6 hours to the current baseline for an initial operation report on current Form ATS, depending on such factors as described above. This would result in an aggregate initial burden of 276 hours above the current baseline for all NMS Stock ATSs to complete Part IV, Item 10 of proposed Form ATS-N.<sup>632</sup>

Part IV, Item 11 of proposed Form ATS would require an NMS Stock ATS to describe its sources and uses of market data. Part IV, Item 11(a) would require an NMS Stock ATS to describe the market data used by the NMS Stock ATS and the source of that market data (e.g., market data feeds disseminated by the SIP and market data feeds disseminated directly by an exchange or other trading center or third-party vendor of market data). Part IV, Item 11(b) would require the NMS Stock ATS to describe the specific purpose for which market data is

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<sup>632</sup> (Attorney at 1 hour + Compliance Manager at 2 hours + Sr. Systems Analyst at 3 hours) x 46 NMS Stock ATSs = 276 burden hours.

used by the NMS Stock ATS, including how market data is used to determine the NBBO, protected quotes, pricing of orders and executions, and routing destinations. Form ATS does not specifically require an ATS to describe its sources of market data, though, this information is often important to understanding the execution of orders on an ATS. The Commission is aware based on Form ATS filings that many ATSs that trade NMS stocks provide descriptions related to their use of market data, including providing the name of their market data vendor. The Commission preliminarily believes that the proposed disclosures under Part IV, Item 11 would not impose any significant additional burden on NMS Stock ATSs, which should already be aware of the market data that they use and the manner in which they use it. Accordingly, the Commission preliminarily estimates that, on average, preparing Part IV, Item 11 for a Form ATS-N would add 4 hours to the current baseline for an initial operation report on current Form ATS to describe the sources of market data and the manner in which the NMS Stock ATS uses market data. This would result in an aggregate initial burden of 184 hours above the current baseline for all NMS Stock ATSs to complete Part IV, Item 11 of proposed Form ATS-N.<sup>633</sup>

Part IV, Item 12 of proposed Form ATS-N would require an NMS Stock ATS to make certain disclosures regarding its fees, rebates, and other charges. Part IV, Item 12(a) of proposed Form ATS-N would require an NMS Stock ATS to describe any fees, rebates, or other charges of the NMS Stock ATS (e.g., connectivity fees, subscription fees, execution fees, volume discounts) and provide the range (e.g., high and low) of such fees, rebates, or other charges. Part IV, Item 12(b) of proposed Form ATS-N would require the NMS Stock ATS to describe any differences if the fees, rebates, or other charges of the NMS Stock ATS are not the same for all subscribers

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<sup>633</sup> (Compliance Manager at 2 hours + Sr. Systems Analyst at 2 hours) x 46 NMS Stock ATSs = 184 burden hours.

and persons. Current Form ATS does not require an ATS to disclose and explain its fee structure, and based on Commission experience, few, if any, do so in their current Form ATS filings. The Commission recognizes that, like national securities exchanges, NMS Stock ATSs may adopt a variety of fee structures that may include rebates, incentives for subscribers to bring liquidity to the NMS Stock ATS, more traditional transaction-based fee structures, and other fees such as a monthly subscriber access fee. Depending on the complexity and variety of an NMS Stock ATS's fee structure and the extent to which these fees are not the same for all subscribers and persons, the proposed disclosure burden related to Part IV, Item 12 of proposed Form ATS-N will likely vary. Accordingly, the Commission preliminarily estimates that, on average, preparing Part IV, Item 12 for a Form ATS-N would add 5 hours to the current baseline for an initial operation report on current Form ATS to describe the NMS Stock ATS's fee structure and any differences among subscribers and persons relating to fees, rebates, or other charges. This would result in an aggregate initial burden of 230 hours above the current baseline for all NMS Stock ATSs to complete Part IV, Item 12 of proposed Form ATS-N.<sup>634</sup>

Part IV, Item 13 of proposed Form ATS would require an NMS Stock ATS to describe any arrangements or procedures for trade reporting, clearance, and settlement on the NMS Stock ATS. Part IV, Item 13(a) of proposed Form ATS-N would require an NMS Stock ATS to describe any arrangements or procedures for reporting transactions on the NMS Stock ATS and if the trade reporting procedures are not the same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences. Part IV, Item 13(b) of proposed Form ATS-N would require an NMS Stock ATS to describe any arrangements or procedures undertaken by

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<sup>634</sup> (Attorney at 1 hour + Compliance Manager at 3 hours + Sr. Systems Analyst at 1 hour) x 46 NMS Stock ATSs = 230 burden hours.

the NMS Stock ATS to facilitate the clearance and settlement of transactions on the NMS Stock ATS (e.g., whether the NMS Stock ATS becomes a counterparty, whether it submits trades to a registered clearing agency, or whether it requires subscribers to have arrangements with a clearing firm). If the clearance and settlement procedures are not the same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences. The Commission notes that some of the proposed disclosure requirements of Part IV, Item 13 of proposed Form ATS-N are already required under current Form ATS. Exhibit F of current Form ATS requires ATSs to describe, among other things, their procedures governing execution, reporting, clearance, and settlement of transactions effected through the ATS. Consequently, ATSs that currently trade NMS stocks already have experience providing disclosures related to how they report, clear, and settle transactions on the ATS. Accordingly, the Commission preliminarily believes that preparing Part IV, Item 13 for a Form ATS-N would not impose a significant additional burden above the current baseline for an initial operation report on current Form ATS. The Commission preliminarily estimates that, on average, preparing Part IV, Item 13 for a Form ATS-N would add 0.5 hours to the current baseline for an initial operation report on current Form ATS to provide a more detailed description of the NMS Stock ATS's trade reporting, clearance, and settlement arrangements or procedures. This would result in an aggregate initial burden of 23 hours above the current baseline for all NMS Stock ATSs to complete Part IV, Item 13 of proposed Form ATS-N.<sup>635</sup>

Part IV, Item 14 of proposed Form ATS-N would require an NMS Stock ATS to provide the following information if the NMS Stock ATS displays orders in an NMS stock to any person

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<sup>635</sup> Compliance Manager at 0.5 hours x 46 NMS Stock ATSs = 23 burden hours.

other than employees of the NMS Stock ATS and executed 5% or more of the average daily trading volume in that NMS stock as reported by an effective transaction reporting plan for four of the preceding six calendar months: (a) the ticker symbol for each NMS stock for each of the last 6 calendar months; (b) a description of the manner in which the NMS Stock ATS displays such orders on a national securities exchange or through a national securities association; and (c) a description of how the NMS Stock ATS provides access to such orders displayed in the national market system equivalent to the access to other orders displayed on that exchange or association. Part IV, Item 15 of proposed Form ATS-N would require an NMS Stock ATS to provide the following information if the NMS Stock ATS executed 5% or more of the average daily trading volume in an NMS stock as reported by an effective transaction reporting plan for four of the preceding six calendar months: (a) the ticker symbol for each NMS stock for each of the last 6 calendar months; and (b) a description of the written standards for granting access to trading on the NMS Stock ATS. Current Form ATS does not require an ATS to disclose the information that would be required under Part IV, Items 14 and 15 of proposed Form ATS-N. However, based on the experience of the Commission and its staff, the Commission preliminarily believes that no ATSs currently executed 5% or more of the average daily volume in an NMS Stock as reported by an effective transaction reporting plan for four of the preceding six calendar months, and the Commission preliminarily believes that most – if not all – ATSs that currently trade NMS stocks already have procedures in place to prevent that threshold from being crossed on the ATS's system. Historically, ATSs have crossed these thresholds very rarely, with at most three ATSs that trade NMS stocks crossing either of the thresholds in any given year.

If, however, an NMS Stock ATS were to cross these 5% thresholds, a disclosure burden related to amending a Form ATS-N to complete Part IV, Items 14 and 15 of proposed Form ATS-N would result. Because Items 14 and 15 of Part IV are tied to existing obligations that arise from crossing the 5% thresholds pursuant to Rule 301(b)(3) and Rule 301(b)(5)(ii)(A) of Regulation ATS, respectively, the Commission preliminarily believes that NMS Stock ATSs should already be generally aware of the procedures they would follow if the 5% thresholds were crossed, which should reduce the burden associated with the disclosures that would be required under Items 14 and 15. The Commission notes that an NMS Stock ATS would only have to respond to Part IV, Items 14 or 15 of a Form ATS-N if the NMS Stock ATS previously operated as an ATS and triggered the applicable 5% thresholds. The Commission further notes that NMS Stock ATSs would be less likely to have to complete Item 14 as compared to Item 15 because Item 14 requires as an additional precondition that the NMS Stock ATS displays orders in an NMS stock to a person other than employees of the NMS Stock ATS. For new NMS Stock ATSs (i.e., NMS Stock ATSs that did not previously operate as an ATS), the NMS Stock ATS would not have been in operation for at least four months to trigger the applicable thresholds, meaning that such NMS Stock ATSs would only be required to complete Item 14 or 15 (or both) in a Form ATS-N Amendment. The Commission preliminarily estimates that completion of Part IV, Item 14 or 15 in a Form ATS-N Amendment (or in a Form ATS-N in the case of an NMS Stock ATS that previously operated as an ATS), would be 5 hours per item.

As explained above, the Commission notes that triggering the 5% threshold, a precondition necessary to require completion of Part IV, Items 14 and 15 of proposed Form ATS-N, currently occurs, and the Commission preliminarily estimates would continue to occur, very infrequently. Based on the review of Form ATS and Form ATS-R disclosures by the

Commission and its staff, the Commission preliminarily estimates that 1 NMS Stock ATS would have to complete Item 14 and 2 NMS Stock ATSs would have to complete Item 15 in any given year. Accordingly, the Commission preliminarily estimates that the disclosures that would be required under Part IV, Items 14 and 15 of proposed Form ATS-N would result in an aggregate initial burden of 15 hours above the current baseline.<sup>636</sup>

Part IV, Item 16 of proposed Form ATS-N would require an NMS Stock ATS to explain and provide certain aggregate platform-wide market quality statistics that it publishes or otherwise provides to subscribers regarding the NMS Stock ATS. Under Item 16, if the NMS Stock ATS publishes or otherwise provides to one or more subscribers aggregate platform-wide order flow and execution statistics of the NMS Stock ATS that are not otherwise required disclosures under Exchange Act Rule 605 of Regulation NMS, it would be required to: (i) list and describe the categories of the aggregate platform-wide order flow and execution statistics published or provided; (ii) describe the metrics and methodology used to calculate the aggregate platform-wide order flow and execution statistics; and (iii) attach as Exhibit 5 the most recent disclosure of the aggregate platform-wide order flow and execution statistics published or provided to one or more subscribers for each category or metric as of the end of the calendar quarter. An NMS Stock ATS would not be required to develop or publish any new statistics for purposes of making the required disclosures under Item 16; it would only be required to make the disclosures for statistics it already otherwise collects and publishes in the course of its operations. Thus, NMS Stock ATSs that do not publish or otherwise provide aggregate platform-wide market quality statistics would not incur any additional burden due to the

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<sup>636</sup> (Attorney at 2 hours + Compliance Manager at 1 hour + Sr. Systems Analyst at 2 hours) x 3 NMS Stock ATSs = 15 burden hours.

proposed disclosure requirements of Item 16. For NMS Stock ATSs that do provide such statistics, Item 16 would impose an additional burden above the baseline because current Form ATS does not require the disclosure of market quality statistics. The Commission preliminarily estimates that preparing Part IV, Item 16 for a Form ATS-N would add 7 hours to the current baseline for an initial operation report on current Form ATS. This would result in an aggregate initial burden of 322 hours above the current baseline for all NMS Stock ATSs to complete Part IV, Item 16 of proposed Form ATS-N.<sup>637</sup>

**ii. Estimated Burden above the Current Baseline for a Form ATS-N, Form ATS-N Amendment, and Notice of Cessation on Form ATS-N**

**A. Proposed Form ATS-N**

Based on the above analysis of the estimated additional burden for a proposed Form ATS-N, the Commission preliminarily estimates that a proposed Form ATS-N will, on average, require an estimated 121.3 burden hours above the current baseline for an initial operation report on current Form ATS. This results in an estimated 141.3 hours in total, including the current baseline.<sup>638</sup> The Commission notes that ATSs that trade NMS stocks vary in terms of their structure

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<sup>637</sup> (Attorney at 1 hour + Compliance Manager at 1 hour + Senior Systems Analyst at 5 hours) x 46 NMS Stock ATSs = 322 burden hours.

<sup>638</sup> (Current Baseline at 20 hours) + (Parts I and II at 0.5 hours) + (Part III at an average of 47 hours) + (Part IV at an average of 73.5 hours) + (Access to EFFS at 0.3 hours, see infra, Section XII.D.2.b.iv) = 141.3 burden hours. The aggregate totals by professional, including the baseline, are estimated to be approximately 54.8 hours for an Attorney, 43.5 hours for a Compliance Manager, 34.5 hours for a Sr. Systems Analyst, 1 hour for a Sr. Marketing Manager, and 7.5 hours for a Compliance Clerk.

This preliminary estimated burden for a Form ATS-N includes the hour burden associated with completing Part III, Item 2 and Part IV, Items 14 and 15 of proposed Form ATS-N. As explained above, however, the Commission preliminarily believes that the majority of NMS Stock ATSs would not be required to complete those items of the proposed form.

and the manner in which they operate. ATSS that currently trade NMS stocks also vary with respect to the depth and extent of their disclosures on Form ATS. Consequently, the Commission preliminarily believes that the estimated hour burdens herein regarding proposed Form ATS-N would likely vary among NMS Stock ATSS, depending on such factors as the extent of their current disclosures on Form ATS, the complexity and structure of their system, and the extent of their other broker-dealer activities.

### **B. Form ATS-N Amendments**

As previously noted, the Commission currently estimates that ATSS that trade NMS stocks submit 2 amendments, on average, each year.<sup>639</sup> The Commission preliminarily estimates that the 46 respondents will file 3 Form ATS-N Amendments each year, for an estimated total of 138 Form ATS-N Amendments. The Commission notes that proposed Rule 304(a)(2) of Regulation ATS will contain the same three general categories of required amendments for proposed Form ATS-N as Rule 301(b)(2) of Regulation ATS currently requires for current Form ATS.<sup>640</sup> However, due to the greater detail and number of disclosures required by proposed Form ATS-N, the Commission preliminarily believes that respondents may find it necessary to file a greater number of amendments to proposed Form ATS-N than ATSS that trade NMS stocks currently do on Form ATS. For example, many of the disclosures related to the broker-dealer operator of the NMS Stock ATS contained in Part III of proposed Form ATS-N, which are not required disclosures under

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<sup>639</sup> See supra note 589 and accompanying text. During the fiscal year of 2014, the Commission received 101 amendments from ATSS that trade NMS stocks, of which there were approximately 45 at any given time during 2014. Some ATSS that trade NMS stocks filed as many as 3 amendments while others did not file any amendments in 2014.

<sup>640</sup> See 17 CFR 242.301(b)(2).

current Form ATS, would require an NMS Stock ATS to file Form ATS-N Amendments if the information provided on Form ATS-N changed.

As noted above, the Commission currently estimates that the hourly burden related to an amendment to Form ATS is 6 hours.<sup>641</sup> The Commission preliminarily estimates that the average hourly burden above this current baseline of 6 hours for each Form ATS-N Amendment would be 3 hours to accommodate the more voluminous and detailed disclosures required by Form ATS-N as compared to Form ATS.<sup>642</sup> An NMS Stock ATS would also be required to provide a brief narrative description of the amendment at the top of Form ATS-N and a redline(s) showing changes to Part III and/or Part IV of proposed Form ATS-N.<sup>643</sup> The Commission preliminarily estimates that this requirement would add an additional burden of 0.5 hours to draft the summary and prepare the redline version(s) showing the amendments the NMS Stock ATS is making.<sup>644</sup> This would result in a total estimated hourly burden, including the baseline, of 9.5 hours for a Form ATS-N Amendment,<sup>645</sup> and an aggregate annual burden on all NMS Stock ATSs of 1,311 hours.<sup>646</sup> The Commission notes that the frequency and scope of Form ATS-N Amendments would likely vary,

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<sup>641</sup> See supra note 590 and accompanying text.

<sup>642</sup> Attorney at 1 hour + Compliance Manager at 2 hours = 3 burden hours above the baseline.

<sup>643</sup> See Exhibits 3A and 4A to proposed Form ATS-N.

<sup>644</sup> Compliance Clerk at 0.5 hours. The Commission notes that most word processing software provides for this functionality.

<sup>645</sup> Attorney at 5.5 hours + Compliance Manager at 2 hours + Compliance Clerk at 2 hours = 9.5 burden hours.

<sup>646</sup> 138 amendments per year x 9.5 hours = 1,311 aggregate burden hours. The Commission further estimates that gaining access to EFFS for one additional person on an annual basis would require 0.15 burden hours for each NMS Stock ATS, or 7 hours annually for all NMS Stock ATSs (46 x 0.15 hours = 6.9 hours). Therefore, the aggregate burden hours equals 1,317.9 hours (1,311 hours + 6.9 hours).

similar to amendments to Form ATS, depending on whether the NMS Stock ATS is implementing a significant change requiring substantial revisions to its Form ATS-N or whether the changes are less significant, such as updating the address of the NMS Stock ATS. Some NMS Stock ATSs might not file any Form ATS-N Amendments in a given year, while others – such as NMS Stock ATSs that publish or otherwise provide to one or more subscribers aggregate platform-wide market quality statistics that would be covered by Part IV, Item 16 of proposed Form ATS-N<sup>647</sup> – may file several Form ATS-N Amendments per year.

### **C. Notice of Cessation on Proposed Form ATS-N**

As previously noted, from 2012 through the first half of 2015, there have been an average of 6 ATSS that trade NMS stocks that cease operations each year.<sup>648</sup> Although it is unclear how many NMS Stock ATSS might cease operations each year going forward, for purposes of making a PRA burden estimate, the Commission is estimating that this average would generally remain the same for NMS Stock ATSS using Form ATS-N as economic conditions, business reasons, and other factors may cause some NMS Stock ATSS to cease operations. Accordingly, the Commission preliminarily estimates that 6 respondents may to file a cessation of operation report on proposed Form ATS-N each year. The Commission preliminarily believes that the burden for filing a cessation of operation report on proposed Form ATS-N will not be significantly greater than that for filing a cessation of operation report on current Form ATS because proposed Form ATS-N does not contain any additional requirements for a cessation of operation report. For both Form ATS and proposed Form ATS-N, the primary requirement is to check the appropriate box indicating that the

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<sup>647</sup> See supra Section VIII.P.

<sup>648</sup> See supra Section XII.C.

ATS is ceasing operations. Accordingly, the Commission preliminarily estimates that the average compliance burden for each response would be 2 hours.<sup>649</sup> This would result in an aggregate annual burden of 12 hours for NMS Stock ATSs that choose to cease operations and submit a cessation of operation report on Form ATS-N.<sup>650</sup>

**iii. ATSs that Transact in Both NMS and Non-NMS Stocks**

Under proposed Rule 301(b)(2)(viii) of Regulation ATS, an ATS that effects trades in both NMS stocks and non-NMS stocks would have to submit a Form ATS-N with respect to its trading of NMS stocks and a revised Form ATS that removes discussion of those aspects of the ATS related to the trading of NMS stocks. Under the proposed amendments to Rule 301(b)(9), an ATS that effects trades in both NMS stocks and non-NMS stocks would also be required to file separate Forms ATS-R – one disclosing trading volume in NMS stocks and one disclosing trading volume in non-NMS stocks. Therefore, ATSs that are subject to these proposed requirements would incur: (1) the above baseline burdens related to filing a Form ATS-N and Form ATS-N Amendments;<sup>651</sup> (2) the additional burden of filing a new Form ATS to only disclose information related to non-NMS stock trading activity on the ATS;<sup>652</sup> and (3) the burden of completing and filing two Forms ATS-R.<sup>653</sup>

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<sup>649</sup> Attorney at 1.5 hours + Compliance Clerk at 0.5 hours = 4 burden hours. See supra note 592, and accompanying text.

<sup>650</sup> 2 burden hours x 6 NMS Stock ATSs = 12 aggregate annual burden hours.

<sup>651</sup> See supra Sections XII.D.2.b.ii.A and B.

<sup>652</sup> See supra Section XII.D.2.a and accompanying text for the baseline estimates for submitting an IOR for Form ATS and amendments to Form ATS.

<sup>653</sup> See supra note 593 and accompanying text for the baseline estimate for submitting a Form ATS-R.

Accordingly, the Commission estimates that the total hourly burden for an ATS to separately file a Form ATS for its non-NMS stock trading activity and Form ATS-N for its NMS stock trading activity would be 20 burden hours for the initial operation report on Form ATS for its non-NMS stock trading activity and 141.3 burden hours for its Form ATS-N. The Commission notes that the estimated hour burden related to the initial operation report submission on Form ATS for non-NMS stock trading activity might be less than the estimated 20 burden hours, as, to the extent the NMS Stock ATS in question is currently operating, the description of its non-NMS stock trading activity should already be contained in its existing Form ATS.<sup>654</sup> As previously noted, there are currently 11 ATSs that trade, or have indicated that they expect to trade in Exhibit B to their Form ATS, both NMS stocks and non-NMS stocks on the ATS. Consequently, the Commission preliminarily estimates that the aggregate initial burden on ATSs to file these separate forms would be 1,774.3 hours, and the aggregate annual burden for filing amendments to both forms would be 445.5 hours.<sup>655</sup>

The Commission estimates that the total burden for completing and filing two Form ATS-R would be 4.5 hours, which is 0.5 hours<sup>656</sup> above the current baseline burden of 4 hours

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<sup>654</sup> The hourly burden related to amendments to its Form ATS and Form ATS-N would remain unchanged: 6 estimated burden hours for amendments to Form ATS, and 9.5 estimated burden hours for Form ATS-N Amendments. See supra notes 641 - 645 and accompanying text.

<sup>655</sup> (Form ATS initial operation report at 20 hours + Form ATS-N at 141.3 hours) x 11 ATSs = 1,774.3 aggregate burden hours. Using the estimates of 2 amendments each year to Form ATS, see supra Section XII.D.2.a, and 3 amendments each year to Form ATS-N, see supra Section XII.D.2.b.0.B, the ongoing aggregate burden for these bifurcated ATSs would be ((2 Form ATS Amendments per year x 6 hours) + (3 Form ATS-N Amendments per year x 9.5 hours)) x 11 respondents = 445.5 aggregate ongoing burden hours per year relating to amendments.

<sup>656</sup> Attorney at .5 hours = .5 burden hours.

for filing a Form ATS-R.<sup>657</sup> The Commission preliminarily believes that ATSs required to file two Forms ATS-R would incur an additional burden above the baseline because they would be required to divide their trading statistics between two forms and file each form separately. The Commission does not believe that those ATSs would incur any additional burden to collect the required information because they currently assemble that information when preparing their current Form ATS-R filings. As previously noted, there are currently 11 ATSs that trade, or have indicated that they expect to trade in Exhibit B to their Form ATS, both NMS stocks and non-NMS stocks on the ATS; those ATSs would be required to file a pair of Forms ATS-R four times annually. Consequently, the Commission estimates that the aggregate annual burden of filing two Forms ATS-R for those ATS that effect transactions in both NMS stocks and non-NMS stocks would be 198 hours.<sup>658</sup>

**iv. Access to EDFS**

The Commission proposes that Form ATS-N would be submitted electronically in a structured format and require an electronic signature.<sup>659</sup> Currently, ATSs that transact in NMS stock do not have the ability to access and submit an electronic form. The proposed amendments to Regulation ATS would require that every NMS Stock ATS have the ability to submit forms electronically with an electronic signature. The Commission's proposal contemplates the use of

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<sup>657</sup> See supra note 593 and accompanying text for the baseline estimate for submitting a Form ATS-R.

<sup>658</sup> ((Attorney at 3.5 hours + Compliance Clerk at 1 hour) x (4 filings annually)) x 11 ATSs = 198 aggregate burden hours.

<sup>659</sup> The Commission notes that all estimated burden hours with regard to completing Parts I-V of proposed Form ATS-N, which are explained above and herein, include the estimated burden associated with the proposed requirement that NMS Stock ATSs file proposed Form ATS-N in a structured format, including narrative responses that are block-text tagged.

an online filing system, the EFFS. Based on the widespread use and availability of the Internet, the Commission preliminarily believes that filing Form ATS-N in an electronic format would be less burdensome and a more efficient filing process for NMS Stock ATSs and the Commission, as it is likely to be less expensive and cumbersome than mailing and filing paper forms to the Commission.

To access EFFS, an NMS Stock ATS would have to submit to the Commission an External Account User Application (“EAUA”) to register each individual at the NMS Stock ATS who would access the EFFS system on behalf of the NMS Stock ATS. The Commission is including in its burden estimates the burden for completing the EAUA for each individual at an NMS Stock ATS who would request access to EFFS. The Commission estimates that initially, on average, two individuals at each NMS Stock ATS would request access to EFFS through the EAUA, and each EAUA would take 0.15 hours to complete and submit. Therefore, each NMS Stock ATS would require a total of 0.3 hours to complete the requisite EAUAs,<sup>660</sup> or approximately 13.8 hours for all NMS Stock ATSs.<sup>661</sup> The Commission also preliminarily estimates that annually, on average, one individual at each NMS Stock ATS will request access to EFFS through the EAUA.<sup>662</sup> Therefore, the ongoing burden to complete the EAUA would be

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<sup>660</sup> 0.15 hours per EAUA x 2 individuals = 0.3 burden hours per NMS Stock ATS. These estimates are based on the Commission and its staff’s experience with EFFS and EAUAs pursuant to Rule 19b-4 under the Exchange Act. The 0.3 hours represents the time spent by two attorneys. The Commission believes it is appropriate to estimate that, on average, each NMS Stock ATS will submit two EAUAs initially.

<sup>661</sup> 0.30 hours x 46 NMS Stock ATSs = 13.8 burden hours.

<sup>662</sup> The Commission estimates that annually, on average, one individual at each NMS Stock ATS will request access to EFFS through EAUA to account for the possibility that an individual who previously had access to EFFS may no longer be designated as needing such access.

0.15 hours annually for each NMS Stock ATS,<sup>663</sup> or approximately 6.9 hours annually for all NMS Stock ATSS.<sup>664</sup>

In addition, the Commission estimates that each NMS Stock ATS will designate 2 individuals to sign Form ATS-N each year. An individual signing a Form ATS-N must obtain a digital ID, at the cost of approximately \$25 each year. Therefore, each NMS Stock ATS would pay approximately \$50 annually to obtain digital IDs for the individuals with access to EDFS for purposes of signing Form ATS-N,<sup>665</sup> or approximately \$2,300 for all NMS Stock ATSS.<sup>666</sup>

**v. Public Posting on NMS Stock ATS's Website**

Proposed Rule 304(b)(3) would require each NMS Stock ATS to make public via posting on the NMS Stock ATS's website a direct URL hyperlink to the Commission's website that contains the documents enumerated in proposed Rule 304(b)(2). The Commission preliminarily estimates that each NMS Stock ATS would incur an initial, one-time burden to program and configure its website in order to post the required direct URL hyperlink pursuant to proposed Rule 304(b)(3). The Commission preliminarily estimates that this initial, one-time burden would be approximately 2 hours.<sup>667</sup> Because the Commission preliminarily believes that many broker-dealer operators currently maintain a website for their NMS Stock ATSS, the Commission

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<sup>663</sup> 0.15 hours per EAU x 1 individual = 0.15 burden hours.

<sup>664</sup> 0.15 hours x 46 NMS Stock ATSS = 6.9 burden hours.

<sup>665</sup> \$25 per digital ID x 2 individuals = \$50 per NMS Stock ATS.

<sup>666</sup> \$50 per NMS Stock ATS x 46 NMS Stock ATSS = \$2,300.

<sup>667</sup> Senior Systems Analyst at 2 burden hours.

preliminarily estimates that the aggregate initial, one-time burden would be approximately 92 hours.<sup>668</sup>

**vi. Recordkeeping Requirements**

As noted above, the Commission proposes to amend Rule 303(a)(2)(ii)<sup>669</sup> of Regulation ATS to provide that all ATSs must preserve copies of all reports filed pursuant to proposed Rule 304 for the life of the enterprise and any successor enterprise.

Rule 303(a)(ii) currently requires an ATS to preserve copies of reports filed pursuant to Rule 301(b)(2), which include all Form ATS filings, for the life of the enterprise and any successor enterprise. Because NMS Stock ATSs that solely trade NMS stocks would be filing Form ATS-N in lieu of Form ATS under this proposal, the Commission believes that the proposed amendment to Rule 303(a)(ii) would not result in any burden for those ATSs that is not already accounted for under the current baseline burden estimate for Rule 303.<sup>670</sup> For the 11 ATSs that trade, or have indicated in Exhibit B to their Form ATS that they expect to trade both NMS stocks and non-NMS stocks on the ATS, the Commission preliminarily estimates that the burden above the current baseline estimate for preserving records relating to compliance with the proposed amendment to Rule 303(a)(ii) would be approximately 3 hours annually per ATS for a total annual burden above the current baseline burden estimate of 33 hours for all respondents.<sup>671</sup>

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<sup>668</sup> Senior Systems Analyst at 2 hours x 46 NMS Stock ATSs = 92 burden hours.

<sup>669</sup> 17 CFR 242.303(a)(2)(ii).

<sup>670</sup> To comply with all of the record preservation requirements of Rule 303, the Commission currently estimates that ATSs spend approximately 1,380 hours per year. See Rule 303 PRA Update, supra note 575, 78 FR 43943. At an average cost per burden hour of \$104.20, the resultant total related cost of compliance is \$143,796 per year (1,380 burden hours x \$104.20/hour). See id.

<sup>671</sup> 3 additional burden hours x 11 ATSs = 33 aggregate burden hours.

Accordingly, the Commission proposes to modify the current PRA burden for Rule 303 to account for the increased burden on ATSS that trade both NMS stocks and non-NMS stocks.

#### **E. Collection of Information is Mandatory**

All collections of information pursuant to the proposed rules would be mandatory for entities that meet the definition of NMS Stock ATS.

#### **F. Confidentiality of Responses to Collection of Information**

With respect to the proposed amendments to Rules 301(b)(2)(viii) and 304 of Regulation ATS, including proposed Form ATS-N, the Commission would make publicly available on its website all Forms ATS-N upon being declared effective. The Commission would also make publicly available on its website all properly filed Form ATS-N Amendments, and notices of cessation on Form ATS-N. The Commission would not make publicly available on its website Forms ATS-N that the Commission has declared ineffective, but these forms would be available for examination by the Commission and its staff, state securities authorities, and self-regulatory organizations. The proposed Form ATS amendments would also require each NMS Stock ATS that has a website to post on the NMS Stock ATS's website a direct URL hyperlink to the Commission's website that contains the documents enumerated in proposed Rule 304(b)(2). The collection of information required by the proposed amendments to Rules 301(b)(10), 303(a)(1)(v), 301(b)(9), and 303(a)(2)(ii) would not be made public, but would be used for regulatory purposes by the Commission and the SRO(s) of which the ATS's broker-dealer operator is a member. In Part III, Item 10 of Form ATS-N, however, NMS Stock ATSS would be required to describe the written safeguards and written procedures to ensure confidential treatment of trading information that would be required under the proposed amendment to Rule 301(b)(10); as explained above, the Commission would make certain Form ATS-N filings

publicly available. To the extent that the Commission receives confidential information pursuant to this collection of information, such information would be kept confidential, subject to the provisions of applicable law.

#### **G. Retention Period for Recordkeeping Requirements**

All reports required to be made under proposed Rules 301(b)(2)(viii), 301(b)(9), and 304 of Regulation ATS, including Proposed Form ATS-N, would be required to be preserved during the life of the enterprise and any successor enterprise, pursuant to the proposed amendment to Rule 303(a)(2) of Regulation ATS.

ATSs would be required to preserve a copy of their written safeguards and written procedures to protect subscribers' confidential trading information under proposed Rule 301(b)(10) of Regulation ATS for not less than 3 years, the first 2 years in an easily accessible place, pursuant to proposed Rule 303(a)(1)(v) of Regulation ATS.

#### **H. Request for Comments**

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comment to:

1. Evaluate whether the proposed collection of information is necessary for the proper performance of our functions, including whether the information shall have practical utility;
2. Evaluate the accuracy of our estimate of the burden of the proposed collection of information;
3. Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and

4. Evaluate whether there are ways to minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090, with reference to File Number S7-23-15. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File Number S7-23-15 and be submitted to the Securities and Exchange Commission, Office of FOIA/PA Services, 100 F Street NE., Washington, DC 20549-2736. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

### **XIII. Economic Analysis**

#### **A. Background**

The Commission is concerned that the current regulatory requirements relating to operational transparency for NMS Stock ATSS may no longer fully meet the goals of furthering the public interest and protecting investors. The market for NMS stock execution services consists of registered national securities exchanges, NMS Stock ATSS, and non-ATS broker-dealers that effect OTC transactions. As of the second quarter of 2015, NMS Stock ATSS account for approximately 15.4% of the total dollar volume in NMS stocks and compete with, and operate similar to, registered national securities exchanges. However, relative to registered national securities exchanges, there is limited and differential information publicly available to market participants about how NMS Stock ATSS operate, including how orders interact, match, and execute, and the activities of the broker-dealer operators and their affiliates. Not only is there a lack of consistency with respect to the quality of information that market participants receive from different NMS Stock ATSS, there are also differences due to the fact that for a given NMS Stock ATS, some subscribers might have more detailed information relative to other subscribers about how orders interact, match, and execute on the ATS.

Currently, NMS Stock ATSS provide the Commission with notice of their initial operations and changes to their operations on Form ATS. Although some NMS Stock ATSS voluntarily make their Form ATS publicly available on their website, they are not required to do so, as Form ATS is “deemed confidential when filed.”<sup>672</sup> In light of this, subscribers to these NMS Stock ATSS may have more information about the operations of these NMS Stock ATSS

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<sup>672</sup> See 17 CFR 242.301(b)(2)(vii).

relative to subscribers to NMS Stock ATSs that do not make their Form ATS public. Moreover, an NMS Stock ATS may also make different information available to certain market participants about its operations than it does to other market participants. The Commission is concerned that this limited and differential level of operational transparency around NMS Stock ATSs may impede market participants' ability to adequately discern how their orders interact, match, and execute on NMS Stock ATSs, or fully understand the activities of an NMS Stock ATS's broker dealer-operator and its affiliates, and the conflicts that may arise from such activities. This could thereby impede a market participant's ability to evaluate whether submitting order flow to a particular NMS Stock ATS aligns with its business interests and would help it achieve its investing or trading objectives. In addition, the Commission is concerned that the current lack of transparency around the potential conflicts of interest that arise from the activities of the broker-dealer operator and its affiliates hinders market participants' abilities to protect their interests when doing business on the NMS Stock ATS.

The Commission is concerned that the current market for NMS stock execution services does not address the problems described above. Rather, when demanding services that are typically offered by NMS Stock ATSs – particularly, dark pools – some market participants trade off the less stringent transparency requirements applicable to NMS Stock ATSs, as compared to national securities exchanges, in exchange for obtaining some perceived advantages of trading on these venues, such as keeping their orders dark prior to execution.<sup>673</sup> Furthermore, the difficulty involved in comparing the operations and execution quality of an NMS Stock ATS to the operations and execution quality of national securities exchanges or other NMS Stock ATSs

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<sup>673</sup> See supra notes 123-126 and accompanying text.

may limit the ability of market participants to judge whether that tradeoff actually benefits either themselves or their customers when sending orders to a particular NMS Stock ATS. For example, as noted above, a certain category of subscribers may have access to services offered by an NMS Stock ATS that are not offered to another category of subscribers, but subscribers that fall under the latter category may not be fully aware of any potential disadvantages when submitting orders to that NMS Stock ATS. Furthermore, the Commission preliminarily believes that the NMS Stock ATS would generally not have a strong incentive to fully reveal how it operates to either category of subscriber under the current regulatory regime.

The Commission is proposing to amend Regulation ATS to adopt new Rule 304, which would provide a process for the Commission to determine if an NMS Stock ATS qualifies for the exemption from the definition of “exchange” pursuant to Rule 3a1-1(a)(2) and declare an NMS Stock ATS’s Form ATS-N either effective or ineffective. The proposal would also provide a process for the Commission to suspend, limit, or revoke an NMS Stock ATS’s exemption from the definition of “exchange” under certain circumstances. The Commission is also proposing to amend Regulation ATS to require NMS Stock ATSS to file Form ATS-N, which would require NMS Stock ATSS to provide detailed disclosures about their trading operations and the activities of their broker-dealer operators and their affiliates. The Commission is proposing to make certain Form ATS-N filings public by posting them on the Commission’s website and requiring each NMS Stock ATS that has a website to post on the NMS Stock ATS’s website a direct URL hyperlink to the Commission’s website that contains the documents enumerated in proposed Rule 304(b)(2). The Commission is also proposing to amend Rule 301(b)(10) of Regulation ATS to require that all ATSS have their procedures and safeguards to protect subscribers’ confidential trading information in writing. The proposed amendments seek to improve and

make more consistent the information available to market participants regarding different NMS Stock ATSS' operations and the activities of their broker-dealer operators and their affiliates. The proposed amendments also aim to make the level and type of disclosures more consistent between NMS Stock ATSS. The Commission preliminarily believes that making publicly available a more consistent level of information to all market participants would help them to better evaluate NMS Stock ATSS as potential routing destinations for their orders.

The Commission is sensitive to the economic consequences and effects, including the costs and benefits, of its rules. The following economic analysis identifies and considers the costs and benefits – including the effects on efficiency, competition, and capital formation – that may result from the amendments to Regulation ATS being proposed. These costs and benefits are discussed below and have informed the policy choices described throughout this release.<sup>674</sup>

#### **B. Baseline**

The enhanced transparency and oversight of NMS Stock ATSS that the Commission preliminarily believes would result from the proposed amendments to Regulation ATS would increase the amount of information and improve the quality of information available to all market participants about the operations of NMS Stock ATSS and the activities of their broker-dealer operators and their affiliates. As a result, this information should better inform market

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<sup>674</sup> Exchange Act Section 3(f) requires the Commission, when it is engaged in rulemaking pursuant to the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation. See 15 U.S.C. 78c(f). In addition, Exchange Act Section 23(a)(2) requires the Commission, when making rules pursuant to the Exchange Act, to consider among other matters the impact that any such rule would have on competition and not to adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. See 15 U.S.C. 78w(a)(2).

participants making decisions about which trading venue to route their orders to. The proposed amendments would also affect the competitive dynamics between trading venues that compete for order flow. The numerous parties that would be affected by the proposed amendments include: existing NMS Stock ATSS; potential new NMS Stock ATSS; current and potential subscribers of NMS Stock ATSS; broker-dealers that are affiliated with NMS Stock ATSS and their customers; non-ATS affiliated broker-dealers and their customers; broker-dealers that do not operate NMS Stock ATSS but send order flow to NMS Stock ATSS; institutional investors that periodically transact large trades on NMS Stock ATSS; other persons that seek to effect transactions in NMS stocks on ATSS; and registered national securities exchanges that compete for order flow with NMS Stock ATSS.

The baseline against which economic costs and benefits, as well as the impact of the proposed amendments on efficiency, competition, and capital formation, are measured is the current market and regulatory framework for trading NMS stocks. The baseline, discussed in further detail below, includes statistics on the number of NMS Stock ATSS; current reporting requirements for NMS Stock ATSS; the lack of public disclosure of NMS Stock ATSS' operations, as well as disparate levels of information available to market participants about NMS Stock ATSS' operations and the activities of their broker-dealer operators and their affiliates; and the competitive environment between registered national securities exchanges and NMS Stock ATSS, among NMS Stock ATSS, and between broker-dealers that operate NMS Stock ATSS and broker-dealers that do not operate NMS Stock ATSS.

#### **1. Current NMS Stock ATSS**

In a concept release on equity market structure in 2010, the Commission stated that in the third quarter of 2009 there were 37 dark pools and ECNs that traded NMS stocks, and that they

accounted for 18.7% of total NMS share volume.<sup>675</sup> From mid-May to mid-September 2014, the trading volume of ATSS accounted for approximately 18% of the total dollar volume in NMS stocks.<sup>676</sup> During the second quarter in 2015, 38 ATSS traded NMS stocks<sup>677</sup> and these 38 ATSS accounted for approximately 59 billion shares traded in NMS stocks (approximately \$2.5 trillion in dollar volume), representing approximately 15.0% of total share trading volume (15.4% of total dollar trading volume) on all registered national securities exchanges, ATSS, and non-ATS OTC trading venues in the second quarter of 2015.<sup>678</sup> There have been several changes in the market for NMS stocks execution services that may explain the volatility in fraction of share and dollar volume executed on NMS Stock ATSS since 2009. First, two ECNs have now registered as national securities exchanges.<sup>679</sup> Second, there has been a rise in the number of ATSS

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<sup>675</sup> The Commission used data from the third quarter of 2009. Of these 37 ATSS that traded NMS stocks, 32 were classified as dark pools and 5 were classified as ECNs. These dark pools accounted for 7.9% of total NMS share volume and the ECNs accounted for 10.8% of total NMS share volume. Of the 10.8% attributable to ECNs, 9.8% was attributable to two ECNs that were operated by Direct Edge, which subsequently registered as national securities exchanges. See 2010 Equity Market Structure Release, supra note 124, at 3598-3599.

<sup>676</sup> See SCI Adopting Release, supra note 17, at 72266 n.148 and accompanying text and n.150.

<sup>677</sup> See infra Table 1, “NMS Stock ATSS Ranked by Dollar Trading Volume – March 30, 2015 to June 26, 2015.”

<sup>678</sup> See infra Table 1 “NMS Stock ATSS Ranked by Dollar Trading Volume – March 30, 2015 to June 26, 2015.” Total dollar trading volume on all exchanges and off-exchange trading in the second quarter of 2015 was approximately \$16.3 trillion and approximately 397 billion shares. See id.

<sup>679</sup> EDGA Exchange, Inc. and EDGX Exchange, Inc. (f/k/a Direct Edge ECN) previously operated as ECNs and are now registered national securities exchanges. See In the Matter of the Applications of EDGX Exchange, Inc., and EDGA Exchange, Inc. for Registration as National Securities Exchanges: Findings, Opinion, and Order of the Commission, Securities Exchange Act Release No. 61698 (March 12, 2010), 75 FR 13151 (March 18, 2010) (File Nos. 10-194 and 10-196). Prior to 2009, there were other

operating as dark pools. Since the third quarter of 2009, the number of ATSS operating as dark pools has increased from 32<sup>680</sup> to more than 40 today.<sup>681</sup> In 2009, dark pools accounted for 7.9% of NMS share volume<sup>682</sup> and by the second quarter of 2015, they accounted for 14.9% of NMS share volume.<sup>683</sup> In summary, in recent years, the number of NMS Stock ATSS has increased, and the percentage of NMS stocks executed in dark pools has also increased.

## 2. Current Reporting Requirements for NMS Stock ATSS

Even though ATSS directly compete for order flow in NMS stocks with national securities exchanges, ATSS are exempt from the definition of “exchange” and therefore are not required to register as national securities exchanges with the Commission. An ATSS qualifies for

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ECNs that also became national securities exchanges. BATS Exchange Inc. (f/k/a BATS ECN) previously operated as an ECN and is now a registered national securities exchange. See In the Matter of the Application of BATS Exchange Inc. for Registration as National Securities Exchange: Findings, Opinion, and Order of the Commission, Securities Exchange Act Release No. 58375 (August 18, 2008), 73 FR 49498 (August 21, 2008) (File No. 10-198). NYSE Arca, Inc., (f/k/a Archipelago) previously operated as an ECN and was acquired by the New York Stock Exchange LLC. See Order Granting Approval of Proposed Rule Change and Amendment Nos. 1, 3, and 5 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 6 and 8 Relating to the NYSE's Business Combination With Archipelago Holdings, Inc., Securities Exchange Act Release No. 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (SR-NYSE-2005-77). Finally, The Nasdaq Stock Market LLC, prior to becoming a national securities exchange, acquired Brut ECN and INET ECN. See In the Matter of the Application of the Nasdaq Stock Market LLC for Registration as National Securities Exchange: Findings, Opinion, and Order of the Commission, Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550, n.137 (January 23, 2006) (File No. 10-131).

<sup>680</sup> See supra note 133 and accompanying text.

<sup>681</sup> See supra note 134 and accompanying text.

<sup>682</sup> See supra note 135 and accompanying text.

<sup>683</sup> See infra Table 1 “NMS Stock ATSS Ranked by Dollar Trading Volume – March 30, 2015 to June 26, 2015” and based on data compiled from Forms ATS submitted to the Commission as of the end of the second quarter of 2015.

an exemption from the definition of “exchange” provided by Exchange Act Rule 3a1-1(a)(2) on the condition that it complies with Regulation ATS, including registering as a broker-dealer, which includes joining a self-regulatory organization, such as FINRA. Thus, ATSs can collect and execute orders in securities electronically without registering as a national securities exchanges under Section 6 of the Exchange Act.

A broker-dealer can become an ATS by filing an initial operation report on Form ATS at least 20 days before commencing operations. Form ATS requires, among other things, that the ATS provide information about: classes of subscribers and differences in access to the services offered by the ATS to different groups or classes of subscribers; the securities the ATS expects to trade; any entity other than the ATS involved in its operations; the manner in which the system operates; how subscribers access the trading system; procedures governing order entry and execution; and trade reporting and clearance and settlement of trades on the ATS. Form ATS is not approved by the Commission,<sup>684</sup> rather, it provides the Commission with notice of an ATS’s operations prior to commencing operations.<sup>685</sup>

An ATS must notify the Commission of any changes in its operations by filing an amendment to its Form ATS initial operation report under three circumstances. First, an ATS must amend Form ATS at least 20 days prior to implementing any material change to the operation of the ATS.<sup>686</sup> Second, if any information contained in the initial operation report becomes inaccurate and has not already been reported to the Commission as an amendment, the ATS must file an amendment on Form ATS within 30 calendar days after the end of each

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<sup>684</sup> See supra Section II.B.

<sup>685</sup> See Instruction A.1 to Form ATS.

<sup>686</sup> See 17 CFR 242.301(b)(2)(ii).

calendar quarter.<sup>687</sup> Third, an ATS must also promptly file an amendment on Form ATS correcting information that it previously reported on Form ATS after discovery that the information was inaccurate when filed.<sup>688</sup> Regulation ATS also requires ATSs to report certain information about transactions on the ATS and information about certain activities on Form ATS-R within 30 days after the end of each calendar quarter.<sup>689</sup> Form ATS-R requires that ATSs report both total unit volume and dollar volume of their transactions over the quarter, as well as a list of all subscribers that were participants during the quarter and a list of all securities traded on the ATS at any time during the quarter.<sup>690</sup> In addition to the reporting requirements of Form ATS and Form ATS-R, there are other conditions under Regulation ATS, including those that address order display and access; fees and fair access; capacity, integrity, and security of automated systems; examinations, inspections, and investigations; recordkeeping; procedures to protect subscribers' confidential treatment of trading information; and limitations on the name of the ATS.<sup>691</sup>

All ATSs are currently members of FINRA and must therefore comply with all FINRA rules applicable to broker-dealers. FINRA rules require ATSs to report transaction volume. For instance, FINRA Rule 4552 requires each ATS to report to FINRA aggregate weekly trading volume on a security-by-security basis.<sup>692</sup> FINRA publishes the information regarding NMS

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<sup>687</sup> See 17 CFR 242.301(b)(2)(iii).

<sup>688</sup> See 17 CFR 242.301(b)(2)(iv).

<sup>689</sup> See 17 CFR 242.301(b)(9).

<sup>690</sup> See Form ATS-R.

<sup>691</sup> See supra Section II.B; see also 17 CFR 242.301(b).

<sup>692</sup> See FINRA Rule 4552.

stocks in the S&P500 Index or the Russell 1000 Index and certain exchange-traded products on a two-week delayed basis, and the information on all other NMS stocks and OTC equity securities on a four-week delayed basis.<sup>693</sup> In addition to FINRA Rule 4552, other rules pertaining to the operations of NMS Stock ATSS include FINRA Rules 6160 and 6170, which pertain to the use of a Market Participant Identifier (“MPID”) for trade reporting purposes.<sup>694</sup>

### **3. Lack of Public Disclosure of NMS Stock ATS Operations and the Activities of the Broker-Dealer Operator and the Broker-Dealer Operator’s Affiliates**

Regulation ATS states that information on Form ATS is “deemed confidential when filed.”<sup>695</sup> In the Regulation ATS Adopting Release, the Commission stated that preserving confidentiality of information on Form ATS would provide ATSS “with the necessary comfort to make full and complete filings,” and noted that information required on Form ATS “may be proprietary and disclosure of such information could place alternative trading systems in a disadvantageous competitive position.”<sup>696</sup>

Although the Commission does not require information provided on Form ATS to be made publicly available, the Commission has observed that some NMS Stock ATSS voluntarily make publicly available their Forms ATS.<sup>697</sup> However, even when ATSS publicly disclose their

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<sup>693</sup> See *id.*

<sup>694</sup> See FINRA Rules 6160 and 6170.

<sup>695</sup> See 17 CFR 242.301(b)(2)(vii). While FINRA Rule 4552 requires dissemination of aggregate weekly trading volume on the ATS by stock, this data does not reveal any information about the ATSS trading operations. Some ATSS such as IEX Trading have voluntarily made public information about order size and fill rates, as well as volume that is matched and routed, on a monthly basis. See, e.g., IEX ATS Statistics, available at <http://www.iextrading.com/stats/>.

<sup>696</sup> See Regulation ATS Adopting Release, *supra* note 7, at 70864.

<sup>697</sup> See *supra* note 156.

Form ATS filings, it is often not easy for market participants to systematically compare one NMS Stock ATS to another based on these disclosures because the level of detail and the format in which it is presented on these Form ATSs may vary among the NMS Stock ATSs. In addition, the Commission notes that some of these NMS Stock ATSs do not make public the full version of the Form ATS that has been filed with the Commission. Also, NMS Stock ATSs are under no legal obligation to keep current a Form ATS they have made publicly available, so market participants cannot immediately confirm whether a publicly posted Form ATS is the most recent filing of the NMS Stock ATS.

Furthermore, different information is made available to different market participants regarding the operations of NMS Stock ATSs and the activities of NMS Stock ATSs' broker-dealer operators and their affiliates. NMS Stock ATSs that either voluntarily make their Form ATS publicly available, or publish summary information of their operations, may provide to market participants more information about their operations than NMS Stock ATSs that do not make their Forms ATS or information about their operations publicly available. Furthermore, subscribers to an NMS Stock ATS may have greater access to information about the NMS Stock ATS than other market participants, including the NMS Stock ATS's subscriber manual and access to other subscriber quotes.

NMS Stock ATSs also disclose some execution quality metrics. Exchange Act Rule 605(a) requires every market center, including ATSs, to make publicly available for each calendar month a report containing standardized data on the covered orders in NMS stocks that it

receives for execution from any market participant.<sup>698</sup> Data on execution quality required under Exchange Act Rule 605(a) includes order sizes, execution sizes, effective spreads, price improvement, and quarterly volume of shares traded. As such, market participants have access to actual market quality statistics of execution quality on NMS Stock ATSs. The Commission recognizes that some NMS Stock ATSs may publish or otherwise disclose to subscribers market quality statistics that may be useful to those subscribers in addition to what is currently required by Exchange Act Rule 605. However, the Commission does not believe that such market quality statistics are standardized in terms of how they are calculated, and it does not know how much information subscribers that receive these market quality statistics have about how the NMS Stock ATS calculates the statistics. The Commission preliminarily believes that some subscribers may have access to more information about a given NMS Stock ATS than other ATSs, and also may have more information about that NMS Stock ATS than non-subscribers.

The differences in information that certain subscribers have about an NMS Stock ATS's operations may be manifested through channels other than having differential access to Form ATS, an NMS Stock ATS's subscriber manual, or being granted access to certain market quality statistics as provided by an NMS Stock ATS in addition to what is currently publicly disclosed under Exchange Act Rule 605. To the extent that the NMS Stock ATS provides access to

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<sup>698</sup> A covered order shall mean any market order or any limit order (including immediate-or-cancel orders) received by a market center during regular trading hours at a time when a consolidated best bid and offer is being disseminated, and, if executed, is executed during regular trading hours, but shall exclude any order for which the customer requests special handling for execution, including, but not limited to, orders to be executed at a market opening price or a market closing price, orders submitted with stop prices, orders to be executed only at their full size, orders to be executed on a particular type of tick or bid, orders submitted on a "not held" basis, orders for other than regular settlement, and orders to be executed at prices unrelated to the market price of the security at the time of execution. See Rule 605(a)(8).

services to certain subscribers and not others, the subscribers with greater access to the services of an NMS Stock ATS could be in a position to obtain more knowledge and information about the operations of NMS Stock ATSs than those subscribers who have limited access to the services of the NMS Stock ATS. Therefore, subscribers who have greater access to services offered by the NMS Stock ATS may be able to make more informed choices about their trading decisions relative to subscribers who have limited access to the services of the NMS Stock ATS. For instance, a broker-dealer operator may offer products or services in connection with a subscriber's use of the NMS Stock ATS, and, as a result, these subscribers may receive more favorable terms from the broker-dealer operator with respect to their use of the NMS Stock ATS. Such favorable terms could include preferential routing arrangements, access to certain order types, or access to a faster connection line to the ATS via a co-location service, as opposed to through the broker-dealer operator's SOR (or similar functionality) or algorithm. Granting access to these favorable terms can result in these subscribers having more detailed information about how their orders will interact, match, and execute relative to those of other subscribers. With this detailed information, these subscribers can make more nuanced decisions about which trading venue suits their trading purposes relative to other subscribers who do not have access to these services, and thus do not possess an informational advantage.

Even if having greater access to the services of an NMS Stock ATS yields additional information about the operations of the NMS Stock ATS to certain subscribers, it is possible that subscribers that do not have full access to services of the NMS Stock ATS, and the resulting additional information, may still want to trade on NMS Stock ATSs in spite of their relative informational disadvantage. It is possible that had these subscribers possessed more detailed information about the operations of the NMS Stock ATS, they may have been able to make more

informed – and therefore potentially different – decisions about where to route their orders for execution.

#### 4. NMS Stock ATS Treatment of Subscriber Confidential Trading Information

Under current Rule 301(b)(10) of Regulation ATS,<sup>699</sup> all ATSs must establish adequate safeguards and procedures to protect subscribers' confidential trading information, and, to ensure that those safeguards and procedures are followed, the ATS must also establish adequate oversight procedures.<sup>700</sup> Furthermore, all ATSs are required to preserve certain records pursuant to Rule 303(a)(1).<sup>701</sup> However, neither Rule 301(b)(10) nor Rule 303(a)(1) of Regulation ATS currently require that an ATS have in writing and preserve their safeguards and procedures to protect subscribers' confidential trading information, or their related oversight procedures. Based on the experience of the Commission and its staff from periodic examinations or investigations of ATSs, the Commission preliminarily believes that ATSs – in particular, ATSs whose broker-dealer operators are large, multi-service broker-dealers – currently have and maintain in writing their safeguards and procedures to protect subscribers' confidential trading information, as well as the oversight procedures to ensure such safeguards and procedures are followed. Nevertheless, under the current regulatory environment for ATSs, absent specific questions in an examination by the Commission or its staff, the Commission is not able to determine the specific ATSs that currently have written safeguards and written procedures to protect subscribers' confidential trading information based on the disclosure requirements of current Form ATS.

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<sup>699</sup> 17 CFR 242.301(b)(10).

<sup>700</sup> 17 CFR 242.301(b)(10).

<sup>701</sup> See supra Section X.

## 5. Current State of Competition Between NMS Stock ATSS and Registered National Securities Exchanges

In the market for NMS stock execution services, NMS Stock ATSS not only compete with other NMS Stock ATSS, but they also compete with registered national securities exchanges. As noted previously, while registered national securities exchanges compete with NMS Stock ATSS for order flow, NMS Stock ATSS and registered national securities exchanges are subject to different regulatory regimes, including different obligations to disclose information about their trading operations and activities.<sup>702</sup> For example, ATSS that operate pursuant to the exemption from the definition of “exchange” under Rule 3a1-1(a)(2) must register as broker-dealers,<sup>703</sup> and provide notice of their operations on Form ATS.<sup>704</sup> This notice of operations is not approved or disapproved by the Commission. Form ATS requires ATSS to disclose only limited aspects of their operations, and ATSS are not required to publicly disclose Form ATS, which is “deemed confidential when filed.”<sup>705</sup> In addition, ATSS need not publicly disclose changes to their operations and trading functionality because amendments to Form ATS are not publicly disclosed.<sup>706</sup> Some market participants therefore have limited access to information about NMS Stock ATSS, including information related to the types of subscribers, means of access, order types, market data, and procedures governing the interaction and execution of orders on the NMS Stock ATS. On the other hand, national securities exchanges, with which

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<sup>702</sup> See supra Section I (discussing the different mix of obligations and benefits applicable to ATSS and registered national securities exchanges).

<sup>703</sup> See 17 CFR 242.301(b)(1).

<sup>704</sup> See 17 CFR 242.301(b)(2).

<sup>705</sup> See 17 CFR 242.301(b)(2)(vii).

<sup>706</sup> Id.

NMS Stock ATSS compete for order flow, must register with the Commission on Form 1, must file proposed rule changes with the Commission under Section 19(b) of the Exchange Act, and are SROs. The proposed rule changes of national securities exchanges must be made available for public comment,<sup>707</sup> and in general, these proposed rule changes publicly disclose, among other things, details relating to the exchange's operations, procedures, and fees. National securities exchanges and other SROs also have regulatory obligations, such as enforcing their rules and the federal securities laws with respect to their members, which do not apply to market participants such as ATSS.<sup>708</sup>

While national securities exchanges have more regulatory burdens than NMS Stock ATSS, they also enjoy certain unique benefits that are not afforded to NMS Stock ATSS. While national securities exchanges are SROs, and are thus subject to surveillance and oversight by the Commission, they can still establish norms regarding conduct, trading, and fee structures for external access. ATSS on the other hand are regulated as broker-dealers, and must comply with the rules of FINRA, which is the SRO to which all ATSS currently belong. Trading venues that elect to register as national securities exchanges may gain added prestige by establishing listing standards for their securities. Additionally, national securities exchanges can be direct participants in the NMS plans, such as the ITS, the CTA Plan, Consolidated Quotation System, and the OTC/UTP Plan. Direct participation in these systems may provide a higher degree of transparency and execution opportunity than on NMS Stock ATSS. Furthermore, national

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<sup>707</sup> See 15 U.S.C. 78s(b)(1).

<sup>708</sup> See, e.g., Section 19(b) of the Exchange Act, 15 U.S.C. 78s(b)(1), and Section 6(b) of the Exchange Act, 15 U.S.C. 78f(b).

securities exchanges are entitled to share in market data revenue generated by the CTA<sup>709</sup> and enjoy limited immunity from private liability with respect to their regulatory functions.

Since the adoption of Regulation NMS in 2005, the market for NMS stock execution services has become more and more fragmented and competitive. Currently there are 11 registered national securities exchanges that effect transactions in NMS stocks, namely, NYSE MKT LLC (formerly NYSE AMEX and the American Stock Exchange), BATS Exchange, Inc. (“BATS-Z Exchange”), BATS Y- Exchange, Inc. (“BATS-Y Exchange”) (“BATS-Z Exchange and BATS-Y Exchange, collectively “the BATS Exchanges”), NASDAQ OMX BX, Inc. (formerly the Boston Stock Exchange), Chicago Stock Exchange, Inc., EDGA Exchange, Inc. (“EDGA”), EDGX Exchange, Inc. (“EDGX”), The Nasdaq Stock Market LLC (“Nasdaq”), New York Stock Exchange LLC (“NYSE”), NYSE Arca, Inc. (“NYSE Arca”), and NASDAQ OMX PHLX, Inc. (formerly Philadelphia Stock Exchange).<sup>710</sup>

Several of these national securities exchanges (NYSE Arca, Nasdaq, BATS Z-Exchange, EDGA and EDGX) previously operated as ECNs or acquired ECNs as part of their trading platforms.<sup>711</sup> A reason why an ECN might want to register as a national securities exchange is so that it can participate in and earn market data fees from U.S. tape plans, reduce clearing costs and operate a primary listings business.<sup>712</sup>

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<sup>709</sup> See Regulation ATS Adopting Release, supra note 7, at 70880, 70902-70903 (discussing generally some of the obligations and benefits of registering as a national securities exchange).

<sup>710</sup> As noted above, National Stock Exchange, Inc. ceased trading on its system as of the close of business on May 30, 2014. See supra note 118.

<sup>711</sup> See supra note 679 and accompanying text.

<sup>712</sup> See BATS Global Markets, Inc., Amendment to Form S-1 Registration Statement, available at

Over the past decade, with the increase in fragmentation in the market for execution services, there has been a shift in the market share of trading volume in NMS stocks across trading venues. For example, there has been a decline in market share of trading volume for exchange-listed stocks of the two traditionally dominant trading venues, NYSE and Nasdaq. The market share of the NYSE in NYSE-listed stocks fell dramatically from approximately 80% in 2005 to 20% in 2013, and for Nasdaq-listed stocks, Nasdaq's market share fell by approximately half, from 50% in 2005 to 25% in 2013.<sup>713</sup> Over the same time period, there has been an increase in market share on other newer national securities exchanges such as NYSE Arca, BATS-Z, BATS-Y, EDGA and EDGX, and an increase in the market share of off-exchange trading, which includes both internalization by dealers and trading on NMS Stock ATSS.<sup>714</sup> As discussed above, there has also been an increase in the number of NMS Stock ATSS that operate as dark pools, and the market share for these NMS Stock ATSS has increased.<sup>715</sup> Thus, greater fragmentation in the market for NMS stock execution services over the past decade has resulted in trading volume being executed on different venues, some of which include NMS Stock ATSS, particularly NMS Stock ATSS that operate as dark pools.

As discussed above, NMS Stock ATSS face lower regulatory burdens than national securities exchanges. Because national securities exchanges are SROs, they are subject to

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<http://www.sec.gov/Archives/edgar/data/1519917/000119312512125661/d179347ds1a.htm>.

<sup>713</sup> See Angel, James, Lawrence Harris, and Chester Spatt (2013), "Equity Trading in the 21st Century: An Update," working paper, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1584026](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1584026).

<sup>714</sup> See id.

<sup>715</sup> See supra Section XIII.B.1.

certain regulatory obligations, such as enforcing their own rules and the federal securities laws with respect to their members. NMS Stock ATs do not have such oversight and enforcement responsibilities.<sup>716</sup> The Commission recognizes that the growth in the number of NMS Stock ATs could be driven by these less stringent regulatory obligations.

#### **6. Competition Among NMS Stock ATs**

NMS Stock ATs also compete amongst each other in a niche in the market for NMS stock execution services. The rise in the number of NMS Stock ATs has not only affected competition between national securities exchanges and ATs for order flow of NMS stocks, it has also impacted competition among NMS Stock ATs. Table 1 depicts the market share of total dollar volume for NMS stocks, and the total share volume for NMS stocks for individual ATs, based on data collected from ATs pursuant to FINRA Rule 4552 for 13 weeks of trading from late March 2015 to late June 2015. Even though there are many NMS Stock ATs, much of the NMS stock dollar volume on ATs is transacted by only a handful of venues. Table 1 shows that the top eight NMS Stock ATs ranked by dollar volume accounted for 61.1% of total dollar volume transacted on ATs and 58.9% of total share volume transacted on ATs from late March 2015 to late June 2015.

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<sup>716</sup> See supra note 708.

MPID	ATS Description	Trades	Share Volume	Dollar Volume	% of ATS Dollar Volume	% of ATS Share Volume
CROS	CROS CROSSFINDER	41,672,006	7,551,914,806	\$315,945,661,169	12.61%	12.70%
UBSA	UBSA UBS ATS	43,027,809	6,734,276,556	\$291,180,523,638	11.62%	11.32%
DBAX	DBAX SUPERX	25,242,629	4,678,600,167	\$199,074,916,743	7.94%	7.87%
IEXG	IEXG IEX	18,041,576	4,423,181,973	\$186,499,748,586	7.44%	7.44%
MSPL	MSPL MS POOL (ATS-4)	18,236,411	4,289,819,243	\$156,471,258,204	6.24%	7.21%
DLTA	DLTA DEALERWEB	1,516	764,998,801	\$134,793,690,990	5.38%	1.29%
SGMA	SGMA SIGMA X	18,716,925	3,222,508,033	\$131,407,703,348	5.24%	5.42%
MLX	MLX INSTINCT X	15,015,049	3,360,647,845	\$116,747,351,177	4.66%	5.65%
JPMX	JPMX JPM-X	12,258,446	2,837,510,840	\$116,561,158,849	4.65%	4.77%
ITGP	ITGP POSIT	10,227,796	2,900,218,900	\$111,761,968,834	4.46%	4.88%
KCGM	KCGM KCG MATCHIT	14,173,631	2,423,079,322	\$95,254,726,769	3.80%	4.07%
EBXL	EBXL LEVEL ATS	14,048,531	2,272,446,000	\$94,803,590,528	3.78%	3.82%
BIDS	BIDS BIDS TRADING	4,317,658	2,208,466,908	\$94,153,259,495	3.76%	3.71%
LATS	LATS BARCLAYS ATS ("LX")	13,743,582	2,365,482,491	\$92,785,653,009	3.70%	3.98%
ICBX	ICBX INSTINET CONTINUOUS BLOCK CROSSING SYSTEM (CBX)	7,295,533	1,875,009,482	\$70,029,206,516	2.79%	3.15%
XSTM	XSTM CROSSSTREAM	2,678,027	1,158,257,295	\$40,156,942,579	1.60%	1.95%
LQNT	LQNT LIQUIDNET ATS	18,127	712,524,230	\$31,447,183,492	1.25%	1.20%
IATS	IATS IBKR ATS	2,308,101	722,328,435	\$31,399,360,633	1.25%	1.21%
NYFX	NYFX MILLENNIUM	1,801,107	647,366,571	\$26,977,052,943	1.08%	1.09%
CXCX	CXCX CITI CROSS	3,047,670	680,227,091	\$26,237,183,874	1.05%	1.14%
MSTX	MSTX MS TRAJECTORY CROSS (ATS-1)	4,032,146	670,349,940	\$24,101,728,412	0.96%	1.13%
PDQX	PDQX PDQ ATS	2,843,539	519,782,380	\$22,384,657,822	0.89%	0.87%
XIST	XIST INSTINET CROSSING	111,510	493,513,656	\$19,449,543,200	0.78%	0.83%
BLKX	BLKX BLOCKCROSS	38,984	429,983,908	\$17,125,909,759	0.68%	0.72%
LTPL	LTPL LIGHT POOL	2,275,740	403,527,790	\$15,757,610,861	0.63%	0.68%
LQFI	LQFI LIQUIFI	18,322	233,816,558	\$10,054,937,852	0.40%	0.39%
BTBK	BTBK TRADEBOOK	951,569	217,286,935	\$9,105,149,522	0.36%	0.37%
LQNA	LQNA LIQUIDNET H2O	38,256	218,684,500	\$8,397,182,948	0.34%	0.37%
VRTX	VRTX VORTEX	994,257	218,122,351	\$6,968,936,215	0.28%	0.37%
MLVX	MLVX MERRILL LYNCH (ATS-1)	167,416	53,504,500	\$2,509,930,415	0.10%	0.09%
JEFX	JEFX JET-X	162,053	47,294,192	\$1,505,230,591	0.06%	0.08%
AQUA	AQUA AQUA	3,074	33,993,467	\$1,276,459,816	0.05%	0.06%
RCSL	RCSL RIVERCROSS	169,033	35,504,467	\$1,018,621,752	0.04%	0.06%
WDNX	WDNX XE	10,818	16,495,078	\$965,039,562	0.04%	0.03%
BCDX	BCDX BARCLAYS DIRECTEX	371	27,323,975	\$786,374,698	0.03%	0.05%
MSRP	MSRP MS RETAIL POOL (ATS-6)	44,498	16,392,000	\$754,554,611	0.03%	0.03%
APOG	APOG APOGEE	14,960	3,016,349	\$120,888,304	0.00%	0.01%
PROS	PROS PRO SECURITIES ATS	34	57,700	\$1,874,537	0.00%	0.00%
<b>Total (NMS Stock ATS)</b>		<b>277,748,710</b>	<b>59,467,514,735</b>	<b>\$2,505,972,772,257</b>	<b>100.00%</b>	<b>100.00%</b>
<b>Total Consolidated Volume (NMS stock)<sup>[1]</sup></b>			<b>397,278,958,163</b>	<b>\$16,272,538,057,045</b>		
<b>NMS Stock ATS as a Fraction of Total Consolidated Volume</b>			<b>15.0%</b>	<b>15.4%</b>		
<b>Dark Pools as a Fraction of Total Consolidated Volume<sup>[2]</sup></b>			<b>14.9%</b>	<b>15.3%</b>		

**Table 1: NMS Stock ATs Ranked by Dollar Trading Volume**  
(March 30, 2015 to June 26, 2015)

This table shows the 38 ATs that effected transactions in NMS stocks from March 30, 2015 to June 26, 2015, ranked in descending order by dollar volume transacted. ATS data is reported weekly, and these dates approximately correspond to the second quarter of 2015. Dollar volume transacted on an ATS is calculated by multiplying the share volume for a given NMS stock on the ATS in a given week by the average trade price for that week. Dollar volume for each NMS stock is then aggregated across all NMS stocks that traded on the given ATS in that week. Also reported in this table is the number of trades, share volume, each NMS Stock ATS's market share of all NMS Stock ATS dollar volume and NMS Stock ATS share volume in that quarter. Note: [1] Total Consolidated Volume includes all trading in NMS stocks on all national securities exchanges, ATs, and non-ATS OTC trading. [2] Dark Pools are defined as all NMS Stock ATs with the exception of ECNs.

Sources: Data collected from ATSS pursuant to FINRA Rule 4552; Trade and Quote (TAQ) Data; Market Volume Summary, [available at https://www.batstrading.com/market\\_summary/](https://www.batstrading.com/market_summary/). Data compiled from Forms ATS filed with the Commission as of the end of, and during the second quarter of 2015.

Table 2, which is based on data collected from NMS Stock ATSS pursuant to FINRA Rule 4552 for 13 weeks of trading from late March 2015 to late June 2015, shows the average trade size, which is share volume divided by the number of trades on each of the NMS Stock ATSS. The table reveals marked differences in the average trade size of transactions executed on the various NMS Stock ATSS. Six NMS Stock ATSS had average trade sizes in excess of 10,000 shares. This suggests that some NMS Stock ATSS may receive large block orders and execute large trades.<sup>717</sup> One of the advantages for market participants of trading on block crossing networks is the ability to execute large block orders while minimizing the movement of prices against their trading interest.<sup>718</sup>

While these NMS Stock ATSS on average execute large size trades, the combined market share of these NMS Stock ATSS is only 7.8% when measured in dollar volume, and 3.7% when measured in share volume. The vast majority of NMS Stock ATSS have average trade sizes between 150 and 450 shares. The two NMS Stock ATSS with the highest market shares (measured either in dollar volume or share volume) have average trade sizes of 181 and 157 shares, respectively.

Though NMS Stock ATSS compete with each other in a niche in the market for NMS stock execution services, the trade sizes in Table 2 actually suggest that this niche market may

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<sup>717</sup> For purposes of this analysis we considered block orders as orders of more than 10,000 shares, which is the traditional definition for block orders. See supra note 126.

<sup>718</sup> See supra notes 124-125 and accompanying text.

not be very different from the market as a whole. The average trade size on NMS Stock ATs is 214 shares, which is not significantly different from the average trade size of 181 shares on registered national securities exchanges.<sup>719</sup> Thus, on average, the trade size for executions on NMS Stock ATs and national securities exchanges appears similar.

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<sup>719</sup> These results are consistent with prior findings that average trade sizes on “lit” national securities exchanges are similar to those taking place on “dark ATs.” See Tuttle: ATs Trading in NMS Stocks, supra note 126. Unlike “lit” national securities exchanges, dark ATs do not publicly disseminate top of the limit-order book information. See id. See also supra note 123 and accompanying text.

MPID	ATS Description	Trades	Share Volume	Dollar Volume	Average Trade Size	% of ATS Dollar Volume	% of ATS Share Volume
DLTA	DLTA DEALERWEB	1,516	764,998,801	\$134,793,690,990	504,617	5.38%	1.29%
BCDX	BCDX BARCLAYS DIRECTEX	371	27,323,975	\$786,374,698	73,650	0.03%	0.05%
LQNT	LQNT LIQUIDNET ATS	18,127	712,524,230	\$31,447,183,492	39,307	1.25%	1.20%
LQFI	LQFI LIQUIFI	18,322	233,816,558	\$10,054,937,852	12,762	0.40%	0.39%
AQUA	AQUA AQUA	3,074	33,993,467	\$1,276,459,816	11,058	0.05%	0.06%
BLKX	BLKX BLOCKCROSS	38,984	429,983,908	\$17,125,909,759	11,030	0.68%	0.72%
LQNA	LQNA LIQUIDNET H2O	38,256	218,684,500	\$8,397,182,948	5,716	0.34%	0.37%
XIST	XIST INSTINET CROSSING	111,510	493,513,656	\$19,449,543,200	4,426	0.78%	0.83%
PROS	PROS PRO SECURITIES ATS	34	57,700	\$1,874,537	1,697	0.00%	0.00%
WDNX	WDNX XE	10,818	16,495,078	\$965,039,562	1,525	0.04%	0.03%
BIDS	BIDS BIDS TRADING	4,317,658	2,208,466,908	\$94,153,259,495	511	3.76%	3.71%
XSTM	XSTM CROSSSTREAM	2,678,027	1,158,257,295	\$40,156,942,579	433	1.60%	1.95%
MSRP	MSRP MS RETAIL POOL (ATS-6)	44,498	16,392,000	\$754,554,611	368	0.03%	0.03%
NYFX	NYFX MILLENNIUM	1,801,107	647,366,571	\$26,977,052,943	359	1.08%	1.09%
MLVX	MLVX MERRILL LYNCH (ATS-1)	167,416	53,504,500	\$2,509,930,415	320	0.10%	0.09%
IATS	IATS IBKR ATS	2,308,101	722,328,435	\$31,399,360,633	313	1.25%	1.21%
JEFX	JEFX JET-X	162,053	47,294,192	\$1,505,230,591	292	0.06%	0.08%
ITGP	ITGP POSIT	10,227,796	2,900,218,900	\$111,761,968,834	284	4.46%	4.88%
ICBX	ICBX INSTINET CONTINUOUS BLOCK CROSSING SYSTEM (CBX)	7,295,533	1,875,009,482	\$70,029,206,516	257	2.79%	3.15%
IEGX	IEGX IEX	18,041,576	4,423,181,973	\$186,499,748,586	245	7.44%	7.44%
MSPL	MSPL MS POOL (ATS-4)	18,236,411	4,289,819,243	\$156,471,258,204	235	6.24%	7.21%
JPMX	JPMX JPM-X	12,258,446	2,837,510,840	\$116,561,158,849	231	4.65%	4.77%
BTBK	BTBK TRADEBOOK	951,569	217,286,935	\$9,105,149,522	228	0.36%	0.37%
MLUX	MLUX INSTINCT X	15,015,049	3,360,647,845	\$116,747,351,177	224	4.66%	5.65%
CXCX	CXCX CITI CROSS	3,047,670	680,227,091	\$26,237,183,874	223	1.05%	1.14%
VRTX	VRTX VORTEX	994,257	218,122,351	\$6,968,936,215	219	0.28%	0.37%
RCSL	RCSL RIVERCROSS	169,033	35,504,467	\$1,018,621,752	210	0.04%	0.06%
APOG	APOG APOGEE	14,960	3,016,349	\$120,888,304	202	0.00%	0.01%
DBAX	DBAX SUPERX	25,242,629	4,678,600,167	\$199,074,916,743	185	7.94%	7.87%
PDQX	PDQX PDQX ATS	2,843,539	519,782,380	\$22,384,657,822	183	0.89%	0.87%
CROS	CROS CROSSFINDER	41,672,006	7,551,914,806	\$315,945,661,169	181	12.61%	12.70%
LTPL	LTPL LIGHT POOL	2,275,740	403,527,790	\$15,757,610,861	177	0.63%	0.63%
SGMA	SGMA SIGMA X	18,716,925	3,222,508,033	\$131,407,703,348	172	5.24%	5.42%
LATS	LATS BARCLAYS ATS ("LX")	13,743,582	2,365,482,491	\$92,785,653,009	172	3.70%	3.98%
KCGM	KCGM KCG MATCHIT	14,173,631	2,423,079,322	\$95,254,726,769	171	3.80%	4.07%
MSTX	MSTX MS TRAJECTORY CROSS (ATS-1)	4,032,146	670,349,940	\$24,101,728,412	166	0.96%	1.13%
EBXL	EBXL LEVEL ATS	14,048,531	2,272,446,000	\$94,803,590,528	162	3.78%	3.82%
UBSA	UBSA UBS ATS	43,027,809	6,734,276,556	\$291,180,523,638	157	11.62%	11.32%
Total (NMS Stock ATS)		277,748,710	59,467,514,735	\$2,505,972,772,257	-	100.00%	100.00%
Average Trade Size (NMS Stock ATS)					214		
Average Trade Size (Registered National Exchanges <sup>(1)</sup> )					181		

**Table 2: NMS Stock ATSs Ranked by Average Trade Size  
(March 30, 2015 to June 26, 2015)**

This table shows 38 ATSs that effected transactions in NMS stocks from March 30, 2015 to June 26, 2015, ranked in descending order by average trade size. ATS data is reported weekly, and these dates correspond approximately to the second quarter of 2015. Also reported in this table is the raw number of trades, share volume, dollar volume, and each NMS Stock ATS's market share of all NMS Stock ATS dollar volume and NMS Stock ATS share volume. Dollar volume transacted on an ATS is calculated by multiplying the share volume for a given NMS stock on the ATS in a given week by the average trade price for that week. Dollar volume for each NMS stock is then aggregated across all NMS stocks that traded on the given ATS in that week.

**Note:** [1] Registered national securities exchanges that effect transactions in NMS stocks include NYSE MKT LLC, BATS Exchange, Inc.; BATS Y- Exchange, Inc.; NASDAQ OMX BX, Inc.; Chicago Stock Exchange, Inc.; EDGA Exchange, Inc.; EDGX Exchange, Inc.; The Nasdaq Stock Market LLC; New York Stock Exchange LLC; NYSE Arca, Inc.; and NASDAQ OMX PHLX, Inc. National Stock Exchange ceased trading on May 30, 2014, and is therefore not included in the calculation of average trade size on registered national securities exchanges.

**Sources:** Data collected by ATSs pursuant to FINRA Rule 4552, Trade and Quote (TAQ) Data; Securities Exchange Act Release No. 72107, *supra* note 118.

While many NMS Stock ATSs operating today are similar with respect to the limited transparency they provide with respect to their trading model, the Commission understands that the services offered vary significantly across NMS Stock ATSs. Some NMS Stock ATSs offer mid-point matching services exclusively while others may have more complex matching algorithms. Some other NMS Stock ATSs offer preferential treatment in execution priority to some groups of subscribers, but not others, and some NMS Stock ATSs may allow subscribers to avoid trading with specific counterparties. Additionally, order types and their characteristics can also vary significantly across NMS Stock ATSs, including with respect to how particular order types interact with other order types, which could affect execution priorities. Even though an NMS Stock ATS might not be privy to detailed information about the operations of other NMS Stock ATSs, it may be able to garner general information about the differential services offered by its competitors through websites and forums,<sup>720</sup> enabling it to modify its products and services to better compete within the market for NMS stock execution services. Thus, while an NMS Stock ATS may currently make available certain information about its products and services in an attempt to enable market participants to differentiate the ATS's products and services from those of its competitors, an NMS Stock ATS may not be incented to fully reveal how orders interact, match and execute on its platform, because revealing such information may adversely impact the ATS's position within the market by also informing its competitors.

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Furthermore, a broker-dealer that operates an ATS may also be a subscriber to one or more ATSs that are owned or operated by other broker-dealers, and in this capacity, may obtain information about how such unaffiliated ATS(s) operate. For example, the broker-dealer operator of an ATS that is a subscriber to an unaffiliated ATS may obtain information about order types and priority rules of the unaffiliated ATS.

## **7. Competition Between Broker-Dealers That Operate NMS Stock ATSS and Broker-Dealers That Do Not Operate NMS Stock ATSS**

Competition for NMS stock order flow not only exists between national securities exchanges and NMS Stock ATSS and among NMS Stock ATSS, but also exists between the broker-dealers that operate NMS Stock ATSS and those broker-dealer operators that do not operate NMS Stock ATSS. As discussed above, most ATSS that currently transact in NMS stocks are operated by multi-service broker-dealers that engage in significant brokerage and dealing activities in addition to their ATS operations. These multi-service broker-dealers operate one or more NMS Stock ATS as a complement to the broker-dealer's other service lines, often using the ATS(s) as an opportunity to execute customer orders "in house" before seeking contra-side interest at outside execution venues. They may also execute orders in NMS stocks internally on non-ATS trading centers by trading as principal against such orders, or crossing orders as agent in a riskless principal capacity, before routing the orders to an ATS that they operate.

The current competitive environment in which NMS Stock ATSS operate suggests that broker-dealers who operate their own NMS Stock ATS(s) may have certain trading advantages relative to broker-dealers that do not operate their own NMS Stock ATS. Broker-dealer owned NMS Stock ATSS may provide their business units or affiliates, that are also subscribers to the NMS Stock ATS, access to certain services, which may result in trading advantages, such as providing faster access to the ATS or priority in executions over other subscribers, such as broker-dealers that do not have their own ATS platform and may route their orders to these ATSS.

## 8. Effect of NMS Stock ATSS on the Current Market for NMS Stock Execution Services

As discussed above, the current market for NMS stock execution services consists of competition for order flow among national securities exchanges, NMS Stock ATSSs, and broker-dealers who operate or control non-ATS trading centers.<sup>721</sup> This section specifically discusses the impact that this current market for NMS stock execution services has on trading costs to market participants; the process by which the price of NMS stocks are determined in the market (“price discovery”); and market efficiency.

### a. Trading Costs

Since the adoption of Regulation ATS in 1998 and the implementation of Regulation NMS in 2005, trading costs have, on average, declined significantly in the U.S. Institutional trading costs – particularly for large capitalization stocks – are amongst the lowest in the world.<sup>722</sup> Since 1998, share and dollar trading volume, has generally increased, and with the exception of the financial crisis, bid-ask spreads (both quoted and effective spreads) have narrowed significantly.<sup>723</sup> Some research has suggested that these lower trading costs can, in part, be driven by the rising fragmentation of trading volume and competition for order flow, through the proliferation of new trading venues such as NMS Stock ATSSs.<sup>724</sup>

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<sup>721</sup> See supra Section XIII.A. See also supra note 123 (describing dark pools that are not ATSSs) and note 385 (describing non-ATS trading centers).

<sup>722</sup> See “View Point: US Equity Market Structure: An Investor Perspective,” BlackRock, April 2014: <https://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-us-equity-market-structure-april-2014.pdf>; and Angel, supra note 713.

<sup>723</sup> See BlackRock, supra note 722; and Angel, supra note 713.

<sup>724</sup> See Foucault, Thierry and A.J. Menkveld, 2008, “Competition for Order Flow and Smart Order Routing Systems,” Journal of Finance 63, 19–58; O’Hara, M. and M. Ye, 2011, “Is Market Fragmentation Harming Market Quality?” Journal of Financial Economics 100,

NMS Stock ATSS provide an environment whereby certain market participants can trade at low costs relative to national securities exchanges. For instance, if market participants submit to a national securities exchange a block order or a large “parent” order shredded into smaller “child” orders, they may experience “price impact” when others observe their trading and infer the presence of a large order. That is, the price at which these child orders execute may get subsequently worse from the time of the initial order submission to the time of the final execution of the order. Thus, when working these child orders, the order originator may seek to keep their executions “quiet” to minimize adverse price moves that may otherwise occur as other market participants infer that order originator is an institutional investor that is a large buyer or seller. As such, trading on NMS Stock ATSS may provide a useful tool whereby institutional investors may be able to reduce the extent to which their own trading signals additional trading intentions and obtain enhanced execution quality for their orders.

The current market for NMS stock execution services – which includes NMS Stock ATSS – provides value to market participants. If all NMS Stock ATSS were to cease operations, market participants may incur costs associated with not being able to find an adequate trading venue that offers benefits similar to those that NMS Stock ATSS provide. For example, certain market participants may be unable to find a trading center that adequately minimizes the revelation of their trading interest. Therefore, some of the trades by these market participants, which would have been executed on NMS Stock ATSS, may no longer be executed at all if NMS Stock ATSS cease operations. Even though NMS Stock ATSS provide value to some market participants by allowing them to trade on a venue that mitigates the signaling of information

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459–74; and Colliard, J.E. and Thierry Foucault (2012), “Trading Fees and Efficiency in Limit Order Markets,” Review of Financial Studies 25, 3389–421.

regarding their trading interest while keeping their trading costs at a low level, NMS Stock ATSs are characterized by a lack of transparency regarding their operations and the activities of their broker-dealer operators and the broker-dealer operator's affiliates. Currently, disclosures on Form ATS are not required to be made public, and even when an NMS Stock ATS voluntarily discloses its Form ATS, the information provided tends to be limited. The Commission has also observed that NMS Stock ATSs vary with respect to the depth and extent of their disclosures on Form ATS, including basic aspects of their operations. This heterogeneity in terms of the level of disclosure pertaining to NMS Stock ATS operations has resulted in certain costs for market participants, in that currently a market participant has to expend some effort searching for a trading venue that would serve its investing or trading objectives. A by-product of these search costs for some market participants is uncertainty pertaining to how their orders will be handled. Because there is no current requirement for NMS Stock ATSs to disclose information about their operations to the public, some subscribers to NMS Stock ATSs – particularly subscribers to those NMS Stock ATSs that have not made their Form ATS public – may not fully know how their orders are handled. Furthermore, for a specific NMS Stock ATS, some subscribers may have been provided more information regarding how their orders will interact, match, and execute on the NMS Stock ATS, exacerbating this uncertainty.

**b. Price Discovery**

The current market for NMS stock execution services has resulted in the fragmentation of trading volume. While this fragmentation – which has in part been due to the rise in NMS Stock ATSs – has been a factor in currently providing low trading costs for market participants,<sup>725</sup> the

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See supra note 724.

contributions that this current market for NMS stock execution services provides in terms of price discovery has been mixed. Some academic studies imply that while national securities exchanges and NMS Stock ATs are regulated differently, their coexistence in the current market has had a positive contribution to price discovery, as it has led to more aggressive competition among market participants in providing liquidity, which in turn has improved price discovery.<sup>726</sup> Other academic studies have suggested that because some NMS Stock ATs are crossing networks and often derive their prices from national securities exchanges, price impact costs that result from trading on a national securities exchange harm prices on NMS Stock ATs, resulting in less trading and harming price discovery.<sup>727</sup>

Some academic studies have also suggested that the coexistence of national securities exchanges and NMS Stock ATs has led to market segmentation, *i.e.* to the extent that certain subscribers of NMS Stock ATs have information regarding how orders will interact, match, and execute on an NMS Stock ATs, these subscribers may be able to make more informed decisions about where to route their orders, and, therefore, such subscribers may congregate and trade on either NMS Stock ATs or national securities exchanges based on that information. These academic studies further suggest that this market segmentation, whereby certain subscribers of NMS Stock ATs have information regarding how orders will interact, match and execute and,

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<sup>726</sup> See Boulatov, Alex, and T.J. George, 2013, "Hidden and Displayed Liquidity in Securities Markets with Informed Liquidity Providers," Review of Financial Studies 26, 2095–2137.

<sup>727</sup> See Ye, Mao, 2011, "A Glimpse into the Dark: Price Formation, Transaction Cost and Market Share of the Crossing Network," working paper, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1521494](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1521494).

therefore, trade on NMS Stock ATSs or national securities exchanges, can improve price discovery.<sup>728</sup>

The theory that market segmentation of market participants leads to price discovery relies on the assumption that because trade executions on some NMS Stock ATSs are determined by matching orders, orders of informed market participants are more likely to cluster on one side of the market (either the buy-side or the sell-side).<sup>729</sup> For instance, if informed market participants believe that a security is undervalued, they will be more likely to submit a buy-order; and vice-versa if they believe a security is overvalued. This means that if these informed market participants trade on an NMS Stock ATS, their trading interest will likely cluster towards one side of the market and there will not be enough orders to take the opposite side of their trades. As a result, some orders will not be matched and there would be low rates of execution on NMS Stock ATSs. In contrast, orders by uninformed market participants are less likely to be correlated with one another because the reasons for their trading are somewhat idiosyncratic to the market participant.<sup>730</sup> These orders by uninformed market participants are, therefore, less likely to cluster on one side of the market, because trades by uninformed market participants are not grounded on fundamental information about the stock. As such, the orders from uninformed market participants will likely have higher rates of execution on NMS Stock ATSs relative to

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<sup>728</sup> See Zhu, Haoxiang, 2014, "Do Dark Pools Harm Price Discovery?" Review of Financial Studies 27, 747–789. This academic study specifically examines dark pools.

<sup>729</sup> See id.

<sup>730</sup> Uninformed market participants trade for non-informational reasons. In some cases, they are termed "noise traders," since their trades are based on their beliefs and sentiments, and are not grounded on fundamental information. See Vishwanath, Ramanna, and Chandrasekhar Krishnamurti, 2009, "Investment Management: A Modern Guide to Security Analysis and Stock Selection," Springer Publishing.

rates of executions for informed participants.<sup>731</sup> Accordingly, this academic literature predicts that the set of market participants entering orders on national securities exchanges will contain a proportionately higher level of informed market participants.<sup>732</sup> This segmentation of market participants on NMS Stock ATSS and national securities exchanges potentially could result in informed market participants trading on national securities exchanges, and uninformed market participants trading on NMS Stock ATSS.<sup>733</sup> Because informed market participants have better knowledge about the value of a security than uninformed market participants, this segmentation can improve price discovery on national securities exchanges.<sup>734</sup>

Several academic studies suggest that the presence of NMS Stock ATSS in the current trading environment deteriorates price discovery<sup>735</sup> and liquidity.<sup>736</sup> When trading, informed

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<sup>731</sup> See supra note 728.

<sup>732</sup> See id.

<sup>733</sup> It should be noted that this academic literature posits one theory regarding how the coexistence of national securities exchanges and NMS Stock ATSS results in segmented trading of informed and uninformed market participants. See supra note 728. Contrary to this theory regarding how market segmentation of national securities exchanges and NMS Stock ATSS can affect price discovery, a motivation for informed market participants to trade on NMS Stock ATSS is to minimize the price impact of large trades. Thus, it could be the case that the decision by informed market participants of where to trade is reduced to whether the value of minimizing the price impact of their trades outweighs the heightened execution risk (due to the difficulty in finding a counterparty to take the opposite side of the trade, perhaps because a market participant places a large order) they might incur if they trade on NMS Stock ATSS. See supra note 727.

<sup>734</sup> See Zhu, supra note 729; Comerton-Forde, Carole and T.J. Putnins, 2015, "Dark Trading and Price Discovery," working paper, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2183392](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2183392). Both these studies specifically examine dark pools.

<sup>735</sup> See Ye, Mao, 2011, "A Glimpse into the Dark: Price Formation, Transaction Cost and Market Share of the Crossing Network," working paper, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1521494](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1521494); Degryse, Hans, Frank de Jong and Vincent van Kervel, 2015, "The Impact of Dark Trading and Visible

market participants often balance two types of costs, namely price impact costs and execution costs. On a national securities exchange, an informed market participant's order experiences lower execution risk, but because of price impact, each order is subsequently executed at a worse price.<sup>737</sup> On an NMS Stock ATS, price impact costs are smaller due to there being less informational dissemination than on national securities exchanges, however, the probability of execution decreases as order size increases, due to the increased difficulty in finding a counterparty to take the opposite side of a large trade.<sup>738</sup> Because trading on a national securities exchange generates price impact, the cost associated with this price impact also could affect a market participant's profit on trades executed on an NMS Stock ATS. The reason for this is that NMS Stock ATSs often match orders at prices derived from national securities exchanges, and if trading on these national securities exchanges generates worse prices due to price impact, this could therefore spill over and affect a market participant's profit on trades executed on the NMS Stock ATS. This spillover could result in informed market participants trading less aggressively, which could in turn reduce price discovery.<sup>739</sup> Finally, while low levels of trading on NMS Stock ATSs are not harmful, price discovery is harmed for high levels of trading on NMS Stock

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Fragmentation on Market Quality," Review of Finance 19, 1587-1622. Both these studies specifically examine dark pools.

<sup>736</sup> See Zhu, supra note 729.

<sup>737</sup> See Ye, supra note 735.

<sup>738</sup> See Ye, supra note 735

<sup>739</sup> See Ye, supra note 735 (for theoretical work on this topic). See also Comerton-Forde and Putnins, supra note 734, for empirical work on this topic. Specifically, using Australian data, the latter paper finds that the migration of order flow into dark pools removes valuable information from the price formation process, and leads to increased adverse selection, larger bid-ask spreads (lower liquidity) and larger price impacts on the exchange (lower market quality). Both of these studies specifically examine dark pools.

ATs (i.e., when trading on NMS Stock ATs in a given NMS stock exceeds approximately 10% of dollar volume).<sup>740</sup> This implies that when most orders are filled on NMS Stock ATs, market participants may withdraw displayed quotes because of the reduced likelihood of those orders being filled.<sup>741</sup>

Another element that may affect market quality is order internalization by broker-dealers. Academic literature has previously proposed theoretical models where broker-dealer operators have an incentive to internalize uninformed orders, by trading as principal against such orders or crossing orders as agent in a riskless principal capacity, before routing the orders to their respective ATs.<sup>742</sup> The literature has also argued that internalization of order flow reduces market depth and price informativeness.<sup>743</sup> According to this literature, the internalization of order flow by broker-dealers, some of whom operate NMS Stock ATs, is associated with wider spreads (quoted, effective, and realized), higher price impact per trade, and increased volatility of trades on the registered national securities exchanges, which translates into an increased cost for market participants, where market participants pay approximately \$3.9 million more per security

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<sup>740</sup> See also Comerton-Forde and Putnins, *supra* note 734.

<sup>741</sup> See CFA Institute, 2012, "Dark Pools, Internalization, and Equity Market Quality," available at <http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2012.n5.1>. This study specifically examines dark pools.

<sup>742</sup> See Chordia, Tarun and Avanidhar Subrahmanyam, 1995, "Market making, the tick size, and payment-for-order flow: Theory and evidence," *Journal of Business* 68, 543–75; Easley, Kiefer and O'Hara, 1996, "Cream-skimming or profit-sharing? The curious role of purchased order flow," *Journal of Finance* 51, 811–33.

<sup>743</sup> See Chakravarty, Sugato and Asani Sarkar, 2002, "A model of broker's trading, with applications to order flow internalization," *Review of Financial Economics* 11, 19–36.

per year.<sup>744</sup> In the current operational environment of NMS Stock ATSs, based on the Commission's experience, subscribers' orders or other trading interest could be removed from the broker-dealer's NMS Stock ATS and routed to, among other destinations, another trading center operated by the broker-dealer operator for internalization. Thus, the fact that some broker-dealers operate their own NMS Stock ATS, and yet internalize some order flow rather than executing it on their own NMS Stock ATS, may have a deleterious effect on market quality.

### **c. Market Efficiency**

Currently, the coexistence of national securities exchanges and NMS Stock ATSs seems to have beneficial effects on market efficiency. One academic study suggests that while not all trades that execute on NMS Stock ATSs are large block trades, those that are have been seen to be beneficial to market efficiency.<sup>745</sup> If NMS Stock ATSs were not a viable trading venue for market participants, market participants might not execute large orders at all because of the price impact costs of executing on a national securities exchange. Therefore, the ability for market participants to execute large trades on NMS Stock ATSs generates liquidity. The same study also suggests that small trades that execute on NMS Stock ATSs are beneficial in that they also generate market efficiency.<sup>746</sup>

### **C. Economic Effects and Effects on Efficiency, Competition, and Capital Formation**

The Commission has considered the economic effects of the proposed amendments to Rule 3a1-1(a) and Regulation ATS. This section provides an overview of the broad economic

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<sup>744</sup> See Weaver, Daniel G., 2014, "The Trade-At Rule, Internalization, and Market Quality," working paper, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1846470](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1846470).

<sup>745</sup> See Comerton-Forde and Putnins, *supra* note 734.

<sup>746</sup> See *id.*

considerations relevant to the proposed amendments to Rule 3a1-1(a) and Regulation ATS, and the economic effects, including the costs, benefits, and the effects on efficiency, competition, and capital formation. Additional economic effects, including benefits and costs related to specific requirements of the proposed amendments to Rule 3a1-1(a) and Regulation ATS, are also discussed.

The proposed amendments to Rule 3a1-1(a) and Regulation ATS<sup>747</sup> are designed to generate greater transparency about the operations of NMS Stock ATSS and the activities of their broker-dealer operators and their affiliates. By requiring NMS Stock ATSS to provide detailed, public disclosures about their operations and the activities of their broker-dealer operators and their broker-dealer operators' affiliates, the Commission preliminarily believes that the proposal would reduce the discrepancy in information that different market participants receive about NMS Stock ATS operations and provide market participants – particularly those that have access to less information about NMS Stock ATS operations – with more information about the means by which orders and trading interest interact, match, and execute on NMS Stock ATSS. The Commission preliminarily believes that the proposal would help market participants make better-informed decisions about where to route their orders in order to achieve their trading or investment objectives, improve the efficiency of capital allocation, and enhance execution quality.

The Commission further understands that the proposed amendments to Regulation ATS may generate some uncertainty for NMS Stock ATSS in that, under the proposal, the Commission would declare a Form ATS-N effective or ineffective (which is not currently the

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<sup>747</sup> See supra Sections IV.

case with respect to Form ATS), and this may act as a potential deterrent for ATSS wishing to transact NMS stocks, or legacy NMS Stock ATSS that would be required to file Form ATS-N. Moreover, the proposed amendments to Rule 3a1-1(a) and Regulation ATS could be costly, because NMS Stock ATSS would have to disclose detailed information about their operations and the activities of their broker-dealer operators and their affiliates. Together, these could harm the competitive dynamics in the market for NMS stock execution services, which includes competition between national securities exchanges and NMS Stock ATSS, among NMS Stock ATSS themselves, and between broker-dealers that operate NMS Stock ATSS and those that do not.<sup>748</sup> Increased costs associated with disclosure requirements for NMS Stock ATSS could result in some NMS Stock ATSS exiting the market or could create a disincentive for potential NMS Stock ATSS to enter the market. However, in spite of these costs, and as discussed in more detail below, the Commission preliminarily believes that the NMS Stock ATSS that remain in the market may propagate greater interaction between buyers and sellers who trade on these venues, fostering not only trading between one and another, but also facilitating the price discovery process and capital formation. The consistent set of information that is proposed to be disclosed in Form ATS-N may impact how market participants react in terms of their trading, which may improve market efficiency.<sup>749</sup>

Moreover, the Commission notes that increased transparency regarding the operations of NMS Stock ATSS may impact competition between broker-dealers that operate NMS Stock ATSS and broker-dealers who trade NMS stocks but do not operate an NMS Stock ATSS.

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<sup>748</sup> See infra Section XIII.C.2.

<sup>749</sup> See id.

Because broker-dealers who transact in NMS stocks but do not operate ATSS are not subject to the proposed operational transparency requirements, these broker-dealers may be at a competitive advantage and attract and internalize order flow that would otherwise be entered and executed on NMS Stock ATSS. Furthermore, greater operational transparency of NMS Stock ATSS could also impact competition between NMS Stock ATSS and national securities exchanges, resulting in a larger amount of order flow being executed on national securities exchanges.

Further, the Commission preliminarily believes that the proposed amendments to Rule 301(b)(10) and 303(a)(1) that would require ATSS to establish and preserve written safeguards and written procedures to protect subscribers' confidential trading information, as well as the oversight procedures to ensure such safeguards and procedures are followed should strengthen the effectiveness of those safeguards and procedures and better enable an NMS Stock ATS to protect confidential subscriber trading information and implement and monitor the adequacy of, and the ATS's compliance with, its safeguards and procedures.<sup>750</sup> The Commission also preliminarily believes that requiring ATSS to adopt written safeguards and written procedures will benefit the Commission by helping it better understand, monitor, and evaluate how each ATS protects subscribers' confidential trading information from unauthorized disclosure and access.<sup>751</sup> The Commission also expects that this proposed requirement will help oversight by the SRO of which the NMS Stock ATS's broker-dealer operator is a member.

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<sup>750</sup> See supra Section IX.

<sup>751</sup> See id.

The Commission has attempted, where possible, to quantify the benefits and costs anticipated by the proposed amendments to Rule 3a1-1(a) and Regulation ATS. The Commission notes, however, that many of the costs and benefits of the proposed amendments are difficult to quantify with any degree of certainty. For instance, it is unclear how many NMS Stock ATSS might cease operations (or, less likely, switch to trading in a different class of securities) if they are required to publicly disclose information about their operations on proposed Form ATS-N. It is also unclear how many NMS Stock ATSS may decide to register as national securities exchanges, as some ECNs have in previous years, as a result of the proposed amendments to Rule 3a1-1(a) and Regulation ATS.<sup>752</sup> Therefore, quantifying the effects that the expanded disclosure requirements would have on market liquidity and capital formation is difficult. As the decision for an NMS Stock ATS to continue operating or to exit the market depends on numerous factors, one of which being the extent to which its competitive advantage is driven by its matching methodology or other operational characteristics, the Commission is unable to fully determine the extent to which the proposal would affect this decision. Furthermore, the decision to exit is idiosyncratic to the NMS Stock ATS and the Commission cannot ascertain whether large or small ATSS will be more prone to leaving the market. Additionally, the Commission cannot estimate the fraction of order flow that would be routed to other NMS Stock ATSS or national securities exchanges if some ATSS ceased operations. In light of all of these limitations on available information, the Commission is unable to make reasonable assumptions regarding the number of NMS Stock ATSS that may cease operations and exit the market; the number of NMS Stock ATSS that may register as national securities

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See supra note 679 and accompanying text.

exchanges; or the fraction of order flow that would be routed to other NMS Stock ATSS or national securities exchanges if some ATSS ceased operations. Given that the Commission is unable to make these assumptions, it is unable to quantify the effect of the proposed amendments to Rule 3a1-1(a) and Regulation ATS on trading volume on the NMS Stock ATS as well as quantify the effects on price discovery and market efficiency.

### **1. Costs and Benefits of Proposed Enhanced Filing Requirements**

As discussed above, the Commission is proposing to amend Rule 3a1-1(a) and Regulation ATS to require ATSS that effect transactions in NMS stocks comply with the requirements of proposed Rule 304 in order to qualify for exemption from the definition of “exchange.”<sup>753</sup> The proposed amendments would require an NMS Stock ATS to file reports and amendments pursuant to proposed Rule 304, which includes the requirement to file proposed Form ATS-N, in lieu of current Form ATS, to disclose information about its operations and the activities of its broker-dealer operator and its affiliates.

As noted above, an NMS Stock ATS may provide some subscribers access to certain trading information or services that it does not provide to others.<sup>754</sup> For example, an NMS Stock ATS may offer certain order types or special fees or rebates to particular subscribers, which might result in those subscribers obtaining an advantage when trading on the ATS. The proposed amendments would require NMS Stock ATSS to describe any such differentiation of services or information among subscribers, which would include certain disclosures related to the operations of their broker-dealer operators. The Commission preliminarily believes that

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<sup>753</sup> See supra Section IV (discussing the proposed amendments). See also proposed Rules 3a1-1(a)(2) and (3), 300, 301, and 304.

<sup>754</sup> See Section VII.B.VII.10.

those disclosures would help market participants assess potential conflicts of interest that may adversely impact their trading on the NMS Stock ATS.

Proposed Rule 304 would also provide a process by which the Commission would declare Form ATS-N filings effective or ineffective, and a process by which the Commission would review Form ATS-N Amendments and declare ineffective a Form ATS-N Amendment if it finds that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors. The Commission is also proposing a process by which the Commission could suspend, limit, or revoke an NMS Stock ATS's exemption from the definition of an "exchange" under Rule 3a1-1(a)(2).<sup>755</sup> An NMS Stock ATS would not qualify for the exemption from the definition of "exchange" unless the NMS Stock ATS files Form ATS-N with the Commission and the Commission declares the Form ATS-N effective.<sup>756</sup>

**a. Better Regulatory Oversight and Increased Investor Protection**

The Commission preliminarily believes that the proposed amendments to Rule 3a1-1(a) and Regulation ATS would result in better regulatory oversight of NMS Stock ATSs and increased investor protection. Form ATS discloses only limited aspects of an ATS's operations as compared to the information that would be provided on Form ATS-N by NMS Stock ATSs.

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<sup>755</sup> Pursuant to proposed Rule 304(b)(2), the Commission would publicly post on its website each: order of effectiveness of a Form ATS-N; order of ineffectiveness of a Form ATS-N; effective Form ATS-N; filed Form ATS-N Amendment; order of ineffectiveness of a Form ATS-N Amendment; notice of cessation; and order suspending, limiting, or revoking the exemption from the definition of an "exchange" pursuant to Rule 3a1-1(a)(2). Proposed Rule 304(b)(3) would also require an NMS Stock ATS that has a website to post on its website a direct URL hyperlink to the Commission's website that contains the documents enumerated in proposed Rule 304(b)(2). See supra, Section IV.D.

<sup>756</sup> See supra Section IV.C.5.

Form ATS requires, for example, that an ATS provide information about: classes of subscribers and differences in access to the services offered by the ATS to different groups or classes of subscribers; securities the ATS expects to trade; any entity other than the ATS involved in its operations; the manner in which the system operates; how subscribers access the trading system; procedures governing order entry and execution; and trade reporting, clearance and settlement of trades on the ATS. On the other hand, Form ATS-N would require an NMS Stock ATS to disclose information about the manner of operations of the ATS, including: subscribers; hours of operation; types of orders; connectivity, order entry, and co-location procedures; segmentation of order flow and notice about segmentation; display of order and other trading interest; trading services, including matching methodologies, order interaction rules, and order handling and execution procedures; procedures governing suspension of trading or trading during a system disruption or malfunction; opening, closing, and after hours procedures; outbound routing services; fees; market data; trade reporting; clearance and settlement; order display and execution access (if applicable); fair access (if applicable); and market quality statistics published or provided to one or more subscribers.

In addition, current Form ATS does not require an ATS to disclose information about the activities of the broker-dealer operator and the broker-dealer operator's affiliates in connection with the ATS whereas the enhanced disclosure requirements under proposed Form ATS-N would require an NMS Stock ATS to disclose information about the activities of its broker-dealer operator and the broker-dealer operator's affiliates that may give rise to potential conflicts of interest, including: their operation of non-ATS trading centers and other NMS Stock ATSs; products and services offered to subscribers; arrangements with unaffiliated trading centers; trading activities on the NMS Stock ATS; smart order router (or similar functionality) and

algorithms used to send or receive orders or other trading interest to or from the ATS; personnel and third parties used to operate the NMS Stock ATS; differences in the availability of services, functionalities, or procedures; and safeguards and procedures to protect subscribers' confidential trading information. Accordingly, the Commission preliminarily believes that the enhanced disclosure requirements under proposed Form ATS-N would result in better regulatory oversight of NMS Stock ATSs and increased investor protection by providing the Commission, relevant SROs, and market participants with significantly more information with which to analyze and evaluate how orders are handled and executed on NMS Stock ATSs.

The Commission is proposing that Form ATS-N and Form ATS-N Amendments be filed electronically in a text-searchable format. The Commission preliminarily believes that requiring Form ATS-N and Form ATS-N Amendments to be filed in a text-searchable format, coupled with the enhanced disclosure requirements under the proposal, will facilitate a more effective and thorough review and analysis of NMS Stock ATSs by regulators, which should yield greater insights into the operations of NMS Stock ATSs and the activities of their broker-dealer operators and their affiliates. For example, under the proposal, examiners at the Commission and the SRO of which an NMS Stock ATS is a member would be able to run automated processes to review information disclosed on filed Forms ATS-N and Form ATS-N Amendments in order to select NMS Stock ATSs for examination based on certain criteria for the examination. Additionally, examiners would be better able to assemble and review a larger pool of data regarding NMS Stock ATSs to better inform their examinations. Both such benefits could increase investor protection by improving the effectiveness and efficiency of the examination process.

Furthermore, the Commission preliminarily believes that the proposed process of declaring a Form ATS-N effective or ineffective and the process to review and declare, if necessary, Form ATS-N Amendments ineffective would improve the quality of the information regulators receive from NMS Stock ATSS and increase the protection of investors. The proposed effectiveness process for a Form ATS-N is designed to provide an opportunity for the Commission to review Form ATS-N filings before an NMS Stock ATS commences operations (in the case of new NMS Stock ATSS), or while it continues operations under its Form ATS filing (in the case of legacy NMS Stock ATSS). The Commission preliminarily believes that the proposed process would allow the Commission to evaluate the adequacy of NMS Stock ATSS' disclosures for compliance with the Form ATS-N requirements before declaring the Form ATS-N effective or ineffective. As a result, once the Commission has made an effectiveness or ineffectiveness determination, only an NMS Stock ATS for which a Form ATS-N has been declared effective would be allowed to transact in NMS stocks without registering as a national securities exchange.

The Commission would make Form ATS-N Amendments public upon filing. As a result, a publicly disclosed Form ATS-N Amendment could contain potentially inaccurate or incomplete disclosures at the time it is posted on the Commission's webpage. Prior to the conclusion of its review of a Form ATS-N Amendment, the Commission would make the public aware of the fact that, though the amendment is posted on the Commission's website, it is still pending Commission review and could still be declared ineffective. The Commission preliminarily believes that this process would provide transparency to market participants about the operations of these ATSS and also provide market participants with information about forthcoming changes to the NMS Stock ATS while the Commission's review is pending.

The Commission preliminarily believes that the proposed review and public disclosure process for a Form ATS-N and Form ATS-N Amendments would allow the Commission to better protect investors from potentially inaccurate or incomplete disclosures that could misinform market participants about the operations of an NMS Stock ATS or the activities of its broker-dealer operator, including how their orders may be handled and executed, and thereby impact market participants' decisions about where they should route their orders.

If the Commission declares ineffective a Form ATS-N or Form ATS-N Amendment of an entity, that entity would have the opportunity to address deficiencies in the previously filed form by filing a new Form ATS-N or Form ATS-N Amendment. However, the Commission recognizes that an ineffectiveness declaration could impose costs on that entity – such as costs from having to cease operations, roll back a change in operations, or delay the start of operations – and could impose costs on the overall market for NMS stock execution services resulting from a potential reduction in competition or the removal of a sole provider of a niche service within the market. Furthermore, the removal of a sole provider of a niche service from the market could also impose costs on individual market participants, as they may have to subscribe to another NMS Stock ATS, or they may have to incur the cost of making changes to their SOR (or similar functionality) or algorithm in order to submit their orders for execution. However, NMS Stock ATSS and market participants would not incur these costs unless the Commission declares a Form ATS-N or a Form ATS-N Amendment ineffective. The Commission preliminarily believes that NMS Stock ATSS would be incentivized to comply with the requirements of Form ATS-N, as well as federal securities laws, including the other requirements of Regulation ATS, to avoid an ineffectiveness declaration, which produces benefits to the market. Therefore, the

Commission preliminarily believes that there would be no undue burden imposed in connection with resubmitting Form ATS-N for these entities or from an ineffective declaration in general.

**b. Implementation and Ongoing Costs**

The Commission understands that both new and existing NMS Stock ATSs would incur implementation costs in order to comply with the proposed amendments to Regulation ATS. Regardless of their size and transaction volume, all NMS Stock ATSs would need to ensure that their disclosures meet the requirements of proposed Form ATS-N and that they correctly file their Form ATS-N. NMS Stock ATSs may develop internal processes to ensure correct and complete reporting on Form ATS-N, which can be viewed as a fixed setup cost, which NMS Stock ATSs may have to incur, regardless of the amount of trading activity that takes place on them. As a result, these implementation costs may fall disproportionately on lower-dollar volume NMS Stock ATSs (as opposed to ATSs transacting greater dollar volume), since all ATSs would likely incur these fixed implementation costs. However, smaller NMS Stock ATSs that are not operated by multi-service broker-dealer operators and do not engage in other brokerage or dealing activities in addition to their NMS Stock ATSs would likely incur lower implementation costs because certain sections of proposed Form ATS-N (such as several items of Part III) would not be applicable to these NMS Stock ATSs.

Relative to the baseline, the proposed amendments to Regulation ATS would also impose implementation costs for all NMS Stock ATSs, including legacy ATSs, in that they would require NMS Stock ATSs to adhere to heightened disclosure and reporting requirements regarding their operations. Existing NMS Stock ATSs should already comply with the current requirements of Regulation ATS. Therefore, the compliance costs of the proposed amendments should be incremental relative to the costs associated with the existing requirements.

Specifically, the Commission preliminarily believes that the incremental costs would consist largely of providing new disclosures and updating records and retention policies necessary to comply with the proposed amendments. Based on the analysis for purposes of the PRA, the Commission preliminarily estimates that the proposed amendments to Regulation ATS relating to Rules 301(b)(2)(viii) and 304 of Regulation ATS, including Proposed Form ATS-N, could result in a one-time burden of 141.3 hours for each NMS Stock ATS,<sup>757</sup> which would result in an estimated one-time paperwork compliance cost to an NMS Stock ATS of approximately \$42,838.50.<sup>758</sup> This would result in an aggregate estimated initial hour burden for all NMS Stock ATSs to complete Form ATS-N and comply with proposed Rules 301(b)(2)(viii) and 304 of Regulation ATS of 6,499.8 hours at an estimated cost of \$1,970,571.00.<sup>759</sup>

Furthermore, the Commission preliminarily believes that there would be implementation costs for ATSs that have not reduced to writing their safeguards and procedures to protect subscribers' confidential trading information and their oversight procedures to ensure that those

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<sup>757</sup> See supra note 638 and accompanying text.

<sup>758</sup> (Attorney at \$380 x 54.8 hours) + (Compliance Manager at \$283 x 43.5 hours) + (Senior Systems Analyst at \$260 x 34.5 hours) + (Senior Marketing Manager at \$254 x 1 hour) + (Compliance Clerk at \$64 x 7.5 hours) = \$42,838.50. This preliminary compliance cost estimate for a Form ATS-N includes the estimated costs associated with completing Part III, Item 2 and Part IV, Items 14 and 15 of proposed Form ATS-N, but as explained above, the Commission preliminarily believes that the majority of NMS Stock ATSs would not be required to complete those items of the proposed form. See supra Section XII.D.2.b.

<sup>759</sup> 141.3 burden hours x 46 NMS Stock ATSs = 6,499.8 burden hours. \$42,838.50 x 46 NMS Stock ATSs = \$1,970,571.00. This preliminary aggregate compliance cost estimate assumes that all NMS Stock ATSs would be required to complete Part III, Item 2 and Part IV, Items 14 and 15 of proposed Form ATS-N. However, as noted above, the Commission preliminarily estimates that only 6 NMS Stock ATSs would be required to complete Part III, Item 2, see supra note 604, only 1 NMS Stock ATS would be required to complete Part IV, Item 14, see supra note 636 and accompanying text, and only 2 NMS Stock ATSs would be required to complete Part IV, Item 15, see id.

safeguards and procedures are followed, which are required under Rule 301(b)(10) of Regulation ATS.<sup>760</sup> Based on the analysis for purposes of the PRA, the Commission preliminarily estimates that, in order to comply with the proposed amendments to Rules 301(b)(10) and 303(a)(1)(v) of Regulation ATS,<sup>761</sup> it could take approximately 15 ATSS an estimated one-time burden of up to 10 hours each,<sup>762</sup> resulting in an estimated one-time paperwork cost for each of those 15 ATSS of \$3,484.00 and an aggregate estimated hour burden of 150 hours at an estimated cost of \$52,260.00.<sup>763</sup>

In addition to the implementation costs mentioned above, there are also expected ongoing costs for NMS Stock ATSS to comply with the proposed amendments to Rule 3a1-1(a) and Regulation ATS. For instance, NMS Stock ATSS would incur ongoing costs associated with amending their Forms ATS-N prior to material changes in their operations, or to correct any information that has become inaccurate. Regardless of the reason for filing a Form ATS-N Amendment, the Commission preliminarily estimates for the purposes of the PRA that it could take an NMS Stock ATS approximately 28.5 hours annually<sup>764</sup> to prepare and file its Form ATS-N Amendments at an estimated annual cost of \$8,352.00.<sup>765</sup> This would result in an estimated

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<sup>760</sup> See 17 CFR 242.301(b)(10).

<sup>761</sup> See supra Section IX.

<sup>762</sup> See supra notes 578-580.

<sup>763</sup> (Attorney at \$380 x 9 hours) + (Compliance Clerk at \$64 x 1 hour) = \$3,484.00.  
\$3,484.00 x 15 ATSS = \$52,260.00.

<sup>764</sup> See supra notes 639-646 and accompanying text. As explained above, the Commission preliminarily estimates that each NMS Stock ATS would file 3 Form ATS-N Amendments per year, and the hourly burden per amendment would be 9.5 hours.

<sup>765</sup> (Attorney at \$380 x 16.5 hours) + (Compliance Manager at \$283 x 6 hours) + (Compliance Clerk at \$64 x 6 hours) = \$8,352.00.

aggregate ongoing hour burden for all NMS Stock ATSs to amend their Forms ATS-N and comply with proposed Rules 301(b)(2)(viii) and 304 of Regulation ATS of 1,311 hours at an estimated cost of \$384,192.00 annually.<sup>766</sup>

Furthermore, the proposed amendments to Rules 301(b)(10) and 303(a)(1)(v) relating to written safeguards and written procedures to protect subscribers' confidential trading information would impose ongoing costs for all ATSs. For the purposes of the PRA, the Commission preliminarily estimates it could take approximately 4 hours annually for each ATS to update and maintain these safeguards and procedures,<sup>767</sup> resulting in an estimated annual paperwork cost for each ATS of \$888.00.<sup>768</sup> This would result in an estimated aggregate ongoing hour burden for all ATSs to maintain and update their safeguards and procedures pursuant to proposed Rules 301(b)(10) and 303(a)(1)(v) of 336 hours at an estimated cost of \$74,592.00 annually.<sup>769</sup>

Some existing NMS Stock ATSs that also transact in non-NMS stocks might incur additional costs due to the proposed amendments. As discussed above,<sup>770</sup> pursuant to the proposed amendments to Regulation ATS, an ATS that effects transactions in both NMS stocks and non-NMS stocks would be subject to the requirements of Rule 304 with respect to its NMS stock trading operations and Rule 301(b)(2) with respect to its non-NMS stock trading operations. Accordingly, NMS Stock ATSs that also transact in non-NMS stocks would incur

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<sup>766</sup> 28.5 hours x 46 NMS Stock ATSs = 1,311 hours. \$8,352.00 x 46 NMS Stock ATSs = \$384,192.00.

<sup>767</sup> See supra notes 581-582 and accompanying text.

<sup>768</sup> (Attorney at \$380 x 2 hours) + (Compliance Clerk at \$64 x 2 hours) = \$888.00 annual paperwork cost per ATS.

<sup>769</sup> 4 annual burden hours x 84 ATSs = 336 annual burden hours. \$888.00 annual paperwork cost per ATS x 84 NMS Stock ATSs = \$74,592.00 aggregate annual paperwork cost.

<sup>770</sup> See supra Section IV.C.2.

additional implementation costs when compared to ATSS that only trade NMS stocks because the former group would be required to file both Form ATS-N and a revised Form ATS that removes discussion of those aspects of the ATS related to the trading of NMS stocks. Those NMS Stock ATSS would also be required to file a pair of Forms ATS-R four times annually. For the purposes of the PRA, the Commission preliminarily estimates that the aggregate initial burden for those ATSS to file a Form ATS-N in regard to their NMS stock trading activity and a current Form ATS in regard to their non-NMS stock trading activity would be 1,774.3 hours<sup>771</sup> at an aggregate estimated cost of \$530,491.50.<sup>772</sup> The Commission also preliminarily estimates that that the aggregate annual burden to file separate Forms ATS-R for those ATSS that effect transactions in both NMS stocks and non-NMS stocks would be 198 hours<sup>773</sup> at an aggregate estimated cost of \$1,394.<sup>774</sup> Furthermore, the Commission preliminarily estimates that these ATSS that facilitate transactions in both NMS stocks and non-NMS stocks would incur an additional estimated recordkeeping burden of 3 hours annually per ATS, resulting in an

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<sup>771</sup> See supra notes 654-658 and accompanying text.

<sup>772</sup> ((Attorney for Form ATS at \$380 x 13 hours) + (Attorney for Form ATS-N at \$380 x 54.8 hours) + (Compliance Manager for Form ATS-N at \$283 x 43.5 hours) + (Senior Systems Analyst for Form ATS-N at \$260 x 34.5 hours) + (Senior Marketing Manager for Form ATS-N at \$254 x 1 hour) + (Compliance Clerk for Form ATS at \$64 x 7 hours) + (Compliance Clerk for Form ATS-N at \$64 x 7.5 hours)) x 11 ATSS = \$530,491.50 This preliminary aggregate compliance cost estimate includes the estimated costs associated with completing Part III, Item 2 and Part IV, Items 14 and 15 of proposed Form ATS-N, but as explained above, the Commission preliminarily believes that the majority of NMS Stock ATSS would not be required to complete those items of the proposed form. See supra Section XII.D.2.b.

<sup>773</sup> See supra notes 658 and accompanying text.

<sup>774</sup> (Attorney at \$380 x 3.5 hours) + (Compliance Clerk at \$64 x 1 hours) = \$1,394.

estimated cost of \$312.60 per ATS<sup>775</sup> and an aggregate estimated hour burden of 33 hours at an estimated cost of \$3,438.60, due to the proposed amendments to Rule 303(a)(2)(ii).<sup>776</sup>

Currently, ATSS that transact in NMS stocks do not have the ability to access and file the Form ATS electronically. The Commission proposes that proposed Form ATS-N would be filed electronically in a structured format and would require an electronic signature. These proposed amendments to Regulation ATS would require that every NMS Stock ATS have the ability to file forms electronically with an electronic signature. The Commission's proposal contemplates the use of an online filing system, the EFFS. Based on the widespread use and availability of the Internet, the Commission preliminarily believes that filing Form ATS-N in an electronic format would be less burdensome and a more efficient filing process than the current paper process for NMS Stock ATSS and the Commission, as it is likely to be less expensive and cumbersome than mailing and filing paper forms to the Commission.

To access EFFS, an NMS Stock ATS would need to submit to the Commission an EAUA to register each individual at the NMS Stock ATS who will access the EFFS system on behalf of the NMS Stock ATS. The Commission is including in its estimates the burden for completing the EAUA for each individual at an NMS Stock ATS that will request access to EFFS.<sup>777</sup> For the purposes of the PRA, the Commission preliminarily estimates that initially, on average, two

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<sup>775</sup> At an average cost per burden hour of \$104.20, see Rule 303 PRA Update, supra note 575, 78 FR 43943, the resultant total related cost of compliance for each ATS would be \$312.60 ((3 burden hours) x \$104.20 /hour).

<sup>776</sup> 3 hours x 11 ATSS = 33 burden hours. \$312.60 x 11 ATSS = \$3,438.60. See supra Section XII.D.2.b.vi.

<sup>777</sup> For the purpose of completeness, the Commission has also included the initial estimated burden and costs related to completing the EAUA in its burden and cost estimates for the initial ATS-N filings by NMS Stock ATSS. See supra note 638.

individuals at each NMS Stock ATS will request access to EFFS through the EAUAs, and each EAUAs would require 0.15 hours to complete and submit.<sup>778</sup> Therefore, each NMS Stock ATS would require 0.3 hours to complete the requisite EAUAs<sup>779</sup> at a cost of \$114.00,<sup>780</sup> and the aggregate initial burden would be approximately 13.8 hours for all NMS Stock ATSs<sup>781</sup> at a cost of \$5,244.00.<sup>782</sup> The Commission also preliminarily estimates that annually, on average, one individual at each NMS Stock ATS will request access to EFFS through the EAUAs.<sup>783</sup> Therefore, the ongoing burden to complete the EAUAs would be 0.15 hours annually for each NMS Stock ATS<sup>784</sup> at a cost of \$57.00,<sup>785</sup> and the aggregate ongoing burden would be approximately 6.9 hours for all NMS Stock ATSs<sup>786</sup> at a cost of \$2,622.00.<sup>787</sup>

In addition, the Commission preliminarily estimates that each NMS Stock ATS will designate two individuals to sign Form ATS-N each year. An individual signing a Form ATS-N

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<sup>778</sup> See supra note 660 and accompanying text.

<sup>779</sup> 0.15 hours per EAUAs x 2 individuals = 0.3 burden hours per NMS Stock ATS. These preliminary estimates are based on the Commission and its staff's experience with EFFS and EAUAs pursuant to Rule 19b-4 under the Exchange Act. The 0.3 hours represents the time spent by two attorneys. The Commission believes it is appropriate to estimate that, on average, each NMS Stock ATS will submit two EAUAs initially.

<sup>780</sup> Attorney at \$380 x 0.3 hours per EAUAs = \$114.00.

<sup>781</sup> 0.30 hours per EAUAs x 46 NMS Stock ATSs = 13.8 burden hours.

<sup>782</sup> \$114 cost per NMS Stock ATS x 46 NMS Stock ATSs = \$5,244.00.

<sup>783</sup> The Commission estimates that annually, on average, one individual at each NMS Stock ATS will request access to EFFS through EAUAs to account for the possibility that an individual who previously had access to EFFS may no longer be designated as needing such access.

<sup>784</sup> 0.15 hours per EAUAs x 1 individual = 0.15 hours.

<sup>785</sup> Attorney at \$380 x 0.15 hours per EAUAs = \$57.00.

<sup>786</sup> 0.15 hours x 46 NMS Stock ATSs = 6.9 hours.

<sup>787</sup> \$57 cost per NMS Stock ATS x 46 NMS Stock ATSs = \$2,622.00.

must obtain a digital ID, at the cost of approximately \$25.00 each year. Therefore, each NMS Stock ATS would require approximately \$50.00 annually to obtain digital IDs for the individuals with access to EFFFs for purposes of signing Form ATS-N,<sup>788</sup> and the aggregate initial burden would be approximately \$2,300.00 for all NMS Stock ATSs.<sup>789</sup>

The Commission also preliminarily estimates that NMS Stock ATSs would incur a one-time cost to make public via posting on their websites a direct URL hyperlink to the Commission's website that contains their Form ATS-N filings.<sup>790</sup> For the purposes of the PRA, the Commission preliminarily estimates that this initial, one-time burden would be approximately 2 hours per NMS Stock ATS at an estimated cost of \$520.00,<sup>791</sup> and the aggregate estimated burden for all NMS Stock ATSs would be approximately 92 hours<sup>792</sup> at an estimated cost of \$23,920.00.<sup>793</sup>

## **2. Costs and Benefits of Public Disclosures of Proposed Form ATS-N**

The Commission is proposing Rule 304(b) to mandate greater public disclosure of NMS Stock ATS operations by making Form ATS-N and Form ATS-N Amendments publicly available on the Commission's website, requiring each NMS Stock ATS that has a website to post a direct URL hyperlink to the Commission's website that contains the documents enumerated in proposed Rule 304(b)(2), and providing for the posting of Commission orders

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<sup>788</sup> \$25 per digital ID x 2 individuals = \$50.00 per NMS Stock ATS.

<sup>789</sup> \$50 cost per NMS Stock ATS x 46 NMS Stock ATSs = \$2,300.

<sup>790</sup> See *supra* Section XII.D.2.b.v.

<sup>791</sup> Senior Systems Analyst at \$260 x 2 hours = \$520.00.

<sup>792</sup> 2 hours per NMS Stock ATS x 46 NMS Stock ATSs = 92 burden hours.

<sup>793</sup> \$520 per NMS Stock ATS x 46 NMS Stock ATSs = \$23,920.00.

related to the effectiveness of Form ATS-N on the Commission's website.<sup>794</sup> The Commission's proposal to require such public disclosure is designed, in part, to increase the operational transparency requirements of NMS Stock ATSs in order to bring those requirements more in line with the operational transparency requirements of national securities exchanges.<sup>795</sup> The Commission preliminarily believes the proposal should assist market participants in evaluating and choosing the NMS Stock ATSs to which they may route orders or become a subscriber due to the proposed enhanced disclosure requirements.

As mentioned above, the proposed amendments to Regulation ATS would make Form ATS-N publicly available, thereby improving the information available to market participants and making that information consistent. The Commission is proposing to amend Regulation ATS to require NMS Stock ATSs to file proposed Form ATS-N in lieu of Form ATS.<sup>796</sup> Furthermore, the Commission is proposing to require NMS Stock ATSs to disclose on Form ATS-N detailed information about the activities of the broker-dealer operator of the NMS Stock ATS and the broker-dealer operator's affiliates, including: the operation of non-ATS trading centers and other NMS Stock ATSs; products and services offered to subscribers; arrangements with unaffiliated trading centers; trading activities on the NMS Stock ATS by the broker-dealer operator or any of its affiliates; a SOR(s) (or similar functionality) or algorithm(s) used to send or receive orders or other trading interest to or from the ATS; personnel and third parties used to operate the NMS Stock ATS; differences in the availability of services, functionalities, or

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<sup>794</sup> See supra Section IV.D.

<sup>795</sup> See id.

<sup>796</sup> As discussed above, to the extent an ATS trades both NMS stocks and non-NMS stocks, it would be required to file both a Form ATS and a Form ATS-N.

procedures between the broker-dealer operator or its affiliates and subscribers to the NMS Stock ATS; and safeguards and procedures to protect subscribers' confidential trading information. Proposed Form ATS-N would also require NMS Stock ATSs to provide detailed information about the manner of operations of the ATS, including: subscribers; hours of operation; types of orders; connectivity, order entry, and co-location procedures; segmentation of order flow and notice about segmentation; display of order and other trading interest; trading services, including matching methodologies, order interaction rules, and order handling and execution procedures; procedures governing suspension of trading and trading during a system disruption or malfunction; opening, closing, and after-hours procedures; outbound routing services; market data; fees; trade reporting; clearance and settlement; order display and execution access (if applicable); fair access (if applicable); and market quality statistics published or provided to one or more subscribers. The Commission is proposing to make certain Form ATS-N filings available to the public on the Commission's website and to require an NMS Stock ATS that has a website to post on the NMS Stock ATS's website a direct URL hyperlink to the Commission's website that contains the documents enumerated in proposed Rule 304(b)(2).

Despite NMS Stock ATSs' increasing operational complexities and importance as a source of liquidity for NMS stocks, the Commission preliminarily believes that many market participants have limited information about NMS Stock ATSs' order handling and execution practices. As noted above, while the current disclosures on Form ATS are "deemed confidential when filed," some ATSs voluntarily disclose their Form ATS filings.<sup>797</sup> Accordingly, there is disparate publicly available information regarding the current operations of NMS Stock ATSs.

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<sup>797</sup> See supra note 155-156.

Furthermore, even if an NMS Stock ATS publicly discloses its Form ATS, some subscribers of that ATS may be privy to more detailed information about how their orders are executed, routed and/or prioritized than other subscribers. Accordingly, the Commission preliminarily believes that, often, some subscribers are able to obtain a more complete picture of the operations of an NMS Stock ATS than other subscribers, and as a result, the latter group of subscribers may not be selecting the venue that most suits their investing or trading objectives. In addition, based on Commission experience, the confidentiality of Form ATS has not always resulted in NMS Stock ATSs disclosing significant details regarding their operations, services, and functions.

Therefore, the status quo, as discussed above in Section XIII.B, is characterized by variable levels of public and confidential disclosure by NMS Stock ATSs, which makes it more difficult for both market participants to evaluate NMS Stock ATSs as potential trading venues and regulators to oversee NMS Stock ATSs.

**a. Effects on Market Participants' Trading Decisions**

The Commission preliminarily believes that the public disclosure of Form ATS-N would produce economic benefits for market participants. Specifically, the Commission preliminarily believes that requiring detailed, public disclosures about the operations of NMS Stock ATSs would, among other things, better standardize the type of information market participants receive about those operations. As a result, search costs for market participants would be lower relative to the baseline, as homogenous disclosure requirements for all NMS Stock ATSs as part of the proposed amendments to Regulation ATS should facilitate market participants' comparison of NMS Stock ATSs when deciding which venue most suits their trading purposes. Accordingly, the Commission preliminarily believes the enhanced operational transparency resulting from the

public disclosures on Form ATS-N should aid market participants when evaluating potential trading venues.

The market for NMS stock execution services has also evolved such that national securities exchanges and NMS Stock ATSS have increasingly become direct competitors. However, as explained above, Form ATS filings continue to be “deemed confidential when filed,” while national securities exchanges must publicly file proposed rule changes and publicly disclose their entire rulebooks.<sup>798</sup> The Commission preliminarily believes that replacing the current Form ATS with proposed Form ATS-N and making Form ATS-N public would reduce the discrepancy in information that different market participants receive about NMS Stock ATSS relative to the information they receive about national securities exchanges, which would better enable market participants to compare the stock execution services of NMS Stock ATSS against those of national securities exchanges. For instance, having information allowing a more complete comparison between the trading operations of NMS Stock ATSS and national securities exchanges could reveal to a market participant certain order handling and preferencing differences that might result in superior or inferior treatment of orders handled by an NMS Stock ATS. It could also reveal differences in fee structures among subscribers that may result in costlier or less costly execution on a particular trading platform.

The Commission preliminarily believes that the proposed amendments would appropriately calibrate the level of transparency between NMS Stock ATSS and national securities exchanges, fostering even greater competition for order flow of NMS stocks between those trading platforms. As noted above, the Commission also preliminarily believes that the

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<sup>798</sup> See supra notes 155-162 and accompanying text.

proposed enhanced disclosure requirements for NMS Stock ATSs would calibrate the level of transparency among different NMS Stock ATSs. Moreover, requiring Form ATS-N to be made public upon being declared effective should lead to additional scrutiny of NMS Stock ATSs by market participants. Therefore, the Commission preliminarily believes that the proposal could foster even greater competition for order flow of NMS stocks among NMS Stock ATSs and between NMS Stock ATSs and national securities exchanges, which could lead to lower spreads and thereby foster greater capital formation and increased market liquidity relative to the baseline. This in turn could enhance execution quality and lower information opaqueness surrounding an NMS Stock ATS's operations.

The Commission also preliminarily believes that the proposed requirement for NMS Stock ATSs to disclose whether and how they segment their order flow, any criteria used to assign order flow, and their fee structures should provide market participants with a better understanding of the operating environment for NMS Stock ATSs. Search costs to identify which NMS Stock ATSs better serve a market participant's trading interests should be reduced relative to the baseline, as market participants may be more able to predict how their orders will be executed. Broker-dealers might also make better routing decisions for their particular interests, and the interests of their customers, which might therefore lead to better execution quality. Also, the proposed enhanced disclosure requirements for NMS Stock ATSs could better enable market participants to review trading decisions made by their broker-dealers. This in turn could lower the level of uncertainty that was present in the baseline regarding how orders would be executed on NMS Stock ATSs. As such, the Commission preliminarily believes that the proposed amendments to Regulation ATS could help market participants understand how their

orders will be executed on an NMS Stock ATS and evaluate any potential conflicts of interest involving the broker-dealer operator and its affiliates when handling such orders.

At the same time, the proposed enhanced disclosure requirements for NMS Stock ATSs could benefit certain ATSs or national securities exchanges. For example, market participants would be aware of which NMS Stock ATSs may offer better execution services or better protection against the dissemination of their non-public trading information, and as a result, these ATSs might attract even more order flow. By attracting greater order flow, NMS Stock ATSs might, in turn, provide benefits to market participants by offering them a trading platform that is more liquid and, possibly, has lower trading costs.

In the adopting release for Regulation ATS, the Commission explained that it believed that the regulatory framework established by Regulation ATS would encourage innovation and encourage the growing role of technology in the securities markets.<sup>799</sup> Since the establishment of Regulation ATS, the market for order execution services for trading NMS stocks – particularly on ATSs – has flourished. The number of ATSs that trade NMS stocks has increased substantially since the inception of Regulation ATS, and as of the end of the second quarter of 2015, trading volume of NMS stocks on ATSs accounted for 15% of total share volume.<sup>800</sup> As it is expected to calibrate the level of transparency between NMS Stock ATSs and national securities exchanges, the proposal may foster greater competition for order flow of NMS stocks between these trading platforms. This greater competition for order flow may in turn incentivize

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<sup>799</sup> See Regulation ATS Adopting Release, supra note 7, at 70910.

<sup>800</sup> See supra Section III.A.

NMS Stock ATSS to innovate – particularly in terms of their technology – so that they can attract more trading volume to their venue.

The proposed requirement under Part IV, Item 16 of proposed Form ATS-N to explain and provide aggregate platform-wide order flow and execution statistics regarding the NMS Stock ATS, which are not otherwise required disclosures under Exchange Act Rule 605 of Regulation NMS but still published or otherwise provided to one or more subscribers by the NMS Stock ATS, could have several potential economic effects. The economic effects would depend not only on the extent to which ATSS currently provide or publish such information and the content of the information which the Commission currently does not have (such as what order flow and execution statistics NMS Stock ATSS produce, how they are calculated and whether they are standardized across ATSS, and which subscribers currently receive these statistics),<sup>801</sup> but also on how NMS Stock ATSS choose to comply with the proposed amendments. Some NMS Stock ATSS may not currently disclose market quality statistics not otherwise required under Exchange Act Rule 605, and these ATSS would not incur costs to comply with the proposed disclosure requirements under Part IV, Item 16 of proposed Form ATS-N; therefore, the proposed disclosure requirements would provide no benefits to market participants in such cases. Additionally, there may be some NMS Stock ATSS that currently provide these aggregate platform-wide order flow and execution statistics not just to their subscribers, but also to the broader public. In such cases, the proposed disclosure requirements under Part IV, Item 16 of proposed Form ATS-N may not provide any additional benefit to

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<sup>801</sup> See supra Section XIII.B.3.

market participants because the information required under Item 16 would already be publicly available.

Furthermore, NMS Stock ATSs that currently provide these aggregate platform-wide order flow and execution statistics to one or more subscribers could continue to provide its subscribers with these market quality statistics, in which case, under the proposal, the NMS Stock ATS would publicly disclose these statistics and how they are calculated in proposed Form ATS-N. Another possibility is that these NMS Stock ATSs may choose to stop providing market quality statistics to subscribers so as not to have to publicly disclose information about those statistics and/or the statistics themselves in Form ATS-N. To the extent that an NMS Stock ATS continues to provide aggregate platform-wide order flow and execution statistics to subscribers only, it would publicly disclose and describe how those statistics are calculated in Form ATS-N, and all market participants, not just subscribers would have access to the information, which the Commission preliminarily believes would improve the opportunity for more market participants to benefit from this information. In addition, to the extent that subscribers that receive those market quality statistics currently do not know how the NMS Stock ATS calculates the market quality statistics, the proposal would help these subscribers better understand the statistics, and such information may be useful when evaluating an NMS Stock ATS as a possible venue to which to route orders in order to accomplish their investing or trading objectives.

However, NMS Stock ATSs that choose to publicly disclose aggregate platform-wide order flow and execution statistics regarding the NMS Stock ATS, which are not otherwise required disclosures under Exchange Act Rule 605 of Regulation NMS but still published or otherwise provided to one or more subscribers by the NMS Stock ATS would incur costs to do so. Therefore, some NMS Stock ATSs may choose to comply with the proposal by ceasing to

disclose these market quality statistics to subscribers. As a result, the proposal could reduce transparency to the detriment of the subscribers who currently benefit from the receipt of certain market quality statistics regarding an NMS Stock ATS, which could in turn result in spill-over effects on the market. Furthermore, the decision of whether to continue to disclose such statistics could depend, in part, on how favorable the statistics make the ATS appear. As such, if some NMS Stock ATSs choose to stop disclosing order flow and execution statistics due to the proposed requirements of Item 16 while others decide to make those statistics public through their Form ATS-N filings, market participants may perceive the latter group of NMS Stock ATSs as having better execution quality, and these trading venues may therefore benefit by attracting even more order flow as a result of such perceptions.

As most NMS Stock ATSs are operated by broker-dealers that also engage in other brokerage and dealing activities, a broker-dealer operator of an NMS Stock ATS, or its affiliates, may have business interests that compete with the ATS's subscribers, or customers of its subscribers, which in turn may give rise to potential conflicts of interest.<sup>802</sup> For instance, multi-service broker-dealers may execute orders in NMS stocks internally on non-ATS trading centers by trading as principal against such orders, or by crossing orders as agent in a riskless principal capacity. The Commission preliminarily expects that the proposal could discourage broker-dealer operators from trading internally as principal in their NMS Stock ATS under circumstances where such might raise conflict of interest concerns because those operations would be subject to public scrutiny by market participants seeking to trade on the ATS.

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<sup>802</sup> The Commission notes that, based on information provided on Form ATS, a small number of ATSs solely limit their broker-dealer business to the operation of an ATS.

In addition to the possible conflicts of interest that may arise from internalization, broker-dealer operators that control and operate multiple NMS Stock ATSs may also face conflicts of interest. This is because such broker-dealers might operate competing trading venues for the execution of orders in NMS stocks without having fully separated the functions of these competing trading centers. As a result of these overlapping functionalities, broker-dealers operating multiple NMS Stock ATSs may provide subscribers of one ATS – which could include business units of the broker-dealer or its affiliates – with access to services or information about the other ATS that it does not provide to other subscribers. The Commission preliminarily believes that the proposed enhanced disclosure requirements should provide market participants with information to better evaluate potential conflicts of interest when making trading decisions; any resultant change in order flow to an NMS Stock ATS with such potential conflicts might cause that ATS to alter its operations to reduce such conflicts.

**b. Structuring of Proposed Form ATS-N**

The Commission is proposing that proposed Form ATS-N be filed electronically through the EFTS system in a structured data format. The Commission is proposing to make public on the Commission's website, among other things, an effective Form ATS-N, and each properly filed Form ATS-N Amendment upon filing with the Commission. The Commission would post the Form ATS-N or Form ATS-N Amendment in the same format that the Commission received the data.

The Commission preliminarily believes that by having NMS Stock ATSs file the proposed Form ATS-N in a structured data format, the information's usability for market participants would be enhanced. Once the data is structured, it is not only human-readable, but also becomes machine-readable such that market participants could download the information

directly into databases and analyze it using various software. With structured data, what was static, text-based information that had to be manually and individually reviewed, can be searched and analyzed, facilitating the comparison and aggregation across NMS Stock ATSS.

The Commission understands that there are varying costs associated with varying degrees of structuring. The Commission preliminarily believes that its proposed structuring of proposed Form ATS-N has minimal costs and enhanced benefits for market participants' use of proposed Form ATS-N information. The Commission is proposing that Parts I (Name) and II (Broker-Dealer Operator Registration and Contact Information) of proposed Form ATS-N would be provided as fillable forms on the Commission's EDFS system. The Commission is proposing that Part III (Activities of the Broker-Dealer Operator and Affiliates) of proposed Form ATS-N would be filed in a structured format whereby the filer would provide checkbox responses to certain questions and narrative responses that are block-text tagged by Item. The Commission is proposing that Part IV (The NMS Stock ATS Manner of Operations) of proposed Form ATS-N would also be filed in a structured format in that the filer would block-text tag narrative responses by Item. The Commission is proposing that Part V (Contact Information, Signature Block, and Consent to Service) of proposed Form ATS-N would be provided as fillable forms on the Commission's EDFS system. The Commission also preliminarily believes that requiring NMS Stock ATSS to file proposed Form ATS-N in a structured format could allow market participants to avoid additional costs associated with third party sources who might otherwise extract and structure all the narrative disclosures, and then charge for access to that structured data. The Commission notes that the structuring of Form ATS-N can be in a variety of manners. For example, some or all of the information provided on Form ATS-N could be structured according to a particular standard that already exists, or a new taxonomy that the Commission

creates, or as a single machine-readable PDF. The Commission seeks comment on the manner in which proposed Form ATS-N could be structured to enable the Commission and market participants to better collect and analyze the data.

**c. Effects on Entry and Exit of NMS Stock ATSS**

From an NMS Stock ATS's perspective, the proposed amendments to Regulation ATS may beget uncertainty as to whether its proposed Form ATS-N will be deemed effective or ineffective. Greater uncertainty surrounding this proposed process may act as a deterrent for potential ATSS wishing to effect transactions in NMS stocks. The disclosures required by proposed Form ATS-N would be more comprehensive and require significantly more detail than those required on current Form ATS, which in turn could delay the start of operations for new NMS Stock ATSS. Therefore, the proposed amendments could raise the entry barrier for new entrants to the market for NMS stock execution services.

The Commission is proposing that a legacy NMS Stock ATS would be able to continue its operations pursuant to a previously filed initial operation report on Form ATS pending the Commission's review of its initial Form ATS-N. However, if after notice and opportunity for hearing, the Commission declares the Form ATS-N filed by a legacy NMS Stock ATS ineffective, the ATS would be required to cease operations. The NMS Stock ATS would then have the opportunity to address deficiencies in the previously filed form by filing a new Form ATS-N.<sup>803</sup> The Commission is also proposing to make Form ATS-N Amendments public upon filing and also to make the public aware of which Form ATS-N Amendments filed by NMS Stock ATSS posted on the Commission's website are pending Commission review and could still

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<sup>803</sup> See supra Section IV.C.0.

be declared ineffective. The Commission preliminarily believes that this process would provide immediate transparency to market participants about an NMS Stock ATS's current operations while also notifying market participants that the disclosures in a filed Form ATS-N Amendment are still subject to Commission review. If the Commission declares a Form ATS-N Amendment ineffective, the NMS Stock ATS shall be prohibited from operating pursuant to the ineffective Form ATS-N Amendment. The NMS Stock ATS could, however, continue to operate pursuant to a Form ATS-N that was previously declared effective.<sup>804</sup> Given the uncertainty that may surround the process to declare Form ATS-N effective or ineffective or Form ATS-N Amendments ineffective, coupled with the number and complexity of the new disclosures that would be required under proposed Form ATS-N, some broker-dealer operators of legacy NMS Stock ATSs may find that the costs of compliance with this proposal outweigh the benefits of continuing to operate their NMS Stock ATS, particularly if the operation of the ATS does not constitute a significant source of profit for a broker-dealer operator. As such, the NMS Stock ATS may exit the market.

As explained above, NMS Stock ATSs would incur both implementation and ongoing costs to meet the regulatory requirements under proposed Rule 304. In particular, the proposed rules would require an NMS Stock ATS to file amendments on proposed Form ATS-N to notice a material change to its operations at least 30 days prior to implementing that material change. Under the proposal, if the Commission declares a material amendment ineffective after this advance notice period has expired, the NMS Stock ATS would be required to unwind the material change if it has already been implemented on the ATS or be precluded from proceeding

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<sup>804</sup> Nothing would preclude the NMS Stock ATS from later submitting a new or revised Form ATS-N Amendment for consideration by the Commission.

to implement the change if it was not already implemented. This uncertainty regarding an NMS Stock ATS's ability to implement material changes may also result in some NMS Stock ATSS exiting the market.

Once an NMS Stock ATS's initial Form ATS-N is declared effective by the Commission, the information disclosed on Form ATS-N would be made available to the broader investing public. Proposed Form ATS-N Amendments would be made public upon filing, and in the case the amendments are not declared ineffective by the Commission, the Commission would no longer indicate that the Form ATS-N Amendment is under Commission review.<sup>805</sup> Examples of the operational information that could be disclosed to a given NMS Stock ATS's competitors and the public on proposed Form ATS-N would include: characteristics and use of order types (including indications of interest and conditional orders); order handling and priority distinctions among types of orders and/or subscribers; order entry and display procedures; the allocation and matching of orders, quotes, indications of interest and conditional orders; execution and trade reporting procedures, and aggregate platform-wide market quality statistics regarding the NMS Stock ATS that the NMS Stock ATS currently only provides to subscribers.

While the information elicited on proposed Form ATS-N would be similar to the information that national securities exchanges are required to publicly disclose, the Commission preliminarily believes that the disclosure of this previously non-public information could have some impact on the direction of order flow in the market. For instance, to the extent that an NMS Stock ATS's competitive advantage in the market is driven by its matching methodology, other operational characteristics that are currently confidential, or the non-public disclosure of

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<sup>805</sup> See supra Section IV.D. See also proposed Rule 304(b)(2).

certain aggregate platform-wide market quality statistics provided to subscribers, the disclosure of this information could result in other NMS Stock ATSs implementing similar methodologies, which might cause market participants to direct more order flow to those other NMS Stock ATSs. In addition, some order flow may be directed away from NMS Stock ATSs and towards national securities exchanges or broker-dealers that operate non-ATS trading centers if market participants discover that their orders could receive lower execution quality on an NMS Stock ATS relative to these other trading centers. As such, the proposal may result in lower revenues for some NMS Stock ATSs, and those ATSs may then find it unprofitable to stay in the market. The Commission preliminarily believes that fewer trading venues in the market will affect competition between existing NMS Stock ATSs and national securities exchanges as well as among existing NMS Stock ATSs, which would in turn affect market participants.

Not only could an NMS Stock ATS's competitive advantage be driven by its current matching methodology or other operational characteristics, it could also be driven by the NMS Stock ATS's ability to improve these methodologies through technological innovation or enhancements. Under the proposal, the Commission preliminarily believes that the disclosure of an NMS Stock ATS's innovations in proposed Form ATS-N Amendments could potentially result in certain NMS Stock ATSs losing their technological advantage. If NMS Stock ATSs cannot innovate fast enough to regain their competitive advantage in the market, orders may also flow away from those NMS Stock ATSs, and as a result, these trading venues may choose to exit the market if operating the ATS becomes unprofitable for the broker-dealer operator.

Both large and small NMS Stock ATSs may be affected by the detailed disclosures required under proposed Rule 304 and Form ATS-N, though, the proposal may affect the ability of each type of ATS to stay in the market differently. As noted above, to the extent that an

ATS's dominance in the market – in terms of being able to attract substantial NMS stock trading volume – is driven by its matching methodology or other operational characteristics that are currently confidential, the public disclosure of this information may result in lower revenue for the NMS Stock ATS. If this is the case for a small NMS Stock ATS, or a large ATS without a substantial profit margin, the broker-dealer operator may no longer view the ATS as being profitable and may potentially exit the market altogether. Alternatively, if this is the case for a large NMS Stock ATS or a smaller NMS Stock ATS with large profit margins, while the NMS Stock ATS may not exit the market, such an ATS may need to engage in costly research in order to develop new matching methodologies to stay profitable in the market. Further, if revenue and earnings margins for operating an NMS Stock ATS are below the average for the entire market, the NMS Stock ATS risks being squeezed out by its competitors and would potentially exit the market.<sup>806</sup> The result of this may be that there would be fewer trading venues in the market for NMS stock execution services. This could affect the competition between existing NMS Stock ATSS and national securities exchanges as well as among existing NMS Stock ATSS, which would in turn affect market participants. The Commission notes, however, that many smaller NMS Stock ATSS may not engage in other brokerage or dealing activities in addition to the operation of their NMS Stock ATS. Therefore, certain aspects of proposed Form ATS-N (such as several items of Part III) may not be applicable to smaller NMS Stock ATSS, which would reduce the burdens and mitigate the effects of the proposed disclosure requirements on these smaller NMS Stock ATSS.

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<sup>806</sup> See Singhvi, Surrendra S. and Harsha B. Desai, 1971, "An Empirical Analysis of the Quality of Corporate Financial Disclosure," Accounting Review 46, 129–138.

The Commission expects that the implementation and ongoing costs associated with filing proposed Form ATS-N could also affect the nature of competition. As Table 1 shows, there is a significant degree of difference in the size of NMS Stock ATSS, when measured by dollar or share volume. If the costs associated with filing proposed Form ATS-N become disproportionately greater for smaller volume NMS Stock ATSS, some of these legacy NMS Stock ATSS might cease operations, and exit the market for NMS stock execution services. As explained above, based on analysis for purposes of the PRA, the Commission has calculated preliminary estimates of the implementation and ongoing costs for the proposed amendments to Regulation ATS. The Commission preliminarily believes that the estimated implementation cost is a fixed cost that would be roughly similar across NMS Stock ATSS, regardless of their dollar volume size; this implies that implementation costs will represent a larger fraction of revenue generated on a small NMS Stock ATS relative to that percentage on a large NMS Stock ATS, which could cause some smaller NMS Stock ATSS to exit the market. However, it could be the case that if the NMS Stock ATSS that decide to exit due to this fixed implementation cost only transact small dollar (or share) volume, the Commission may not expect to see a large impact on the overall competitive structure of the NMS Stock ATSS that would remain in the market. More so, the order flow that was being traded on these small NMS Stock ATSS might in fact be absorbed and redistributed amongst these larger surviving NMS Stock ATSS.

Another effect that the proposal could have on competition is that the greater disclosure requirements of NMS Stock ATSS, particular the disclosures related to the other business activities of the broker-dealer operator and its affiliates, may influence a broker-dealer operator's decisions with respect to its operations of the NMS Stock ATS. Given the proposed disclosure requirements regarding the activities of broker-dealer operators and their affiliates, a multi-

service broker-dealer operator of an NMS Stock ATS may cease operating its NMS Stock ATS and send its order flow, which would have gone to the broker-dealer operator's NMS Stock ATS, to other trading centers. For example, a multi-service broker-dealer operator could internalize the order flow that it would typically send to its ATS or send that order flow to a broker-dealer that, does not operate an NMS Stock ATS, to internalize. Alternatively, the broker-dealer operator might send the order flow to a non-affiliated NMS Stock ATS that is operated by a non-multi-service broker-dealer, who would likely not encounter the same potential conflicts of interest as a multi-service broker-dealer that operates an NMS Stock ATS. Finally, the broker-dealer operator could also send its order flow to national securities exchanges for execution.

Overall, the Commission preliminarily believes that the possible exit of NMS Stock ATSS from the market, or the reduced entry of new NMS Stock ATSS, due to the requirements under proposed Rule 304 and Form ATS-N might be potentially harmful to competition in the market for NMS stock execution services. The potential exit by existing NMS Stock ATSS and the reduced entry into the market by prospective NMS Stock ATSS may impact market participants by reducing the number of NMS stock trading venues and thus, reducing a market participant's opportunities to minimize its trading costs by sending orders to different trading platforms. As such, the possible exit of NMS Stock ATSS from the market for NMS stock execution services and lower rate of entry for new NMS Stock ATSS may result in greater costs relative to the baseline cost savings that NMS Stock ATSS currently afford market participants.<sup>807</sup> The Commission, however, is unable to predict whether legacy NMS Stock

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<sup>807</sup> See supra Section XIII.B.7.

ATSS will exit the market and therefore, cannot quantify the ultimate effect that this will have on competition.

**d. Effects on Trading Costs, Price Discovery and Market Efficiency**

As discussed above, the proposed heightened disclosure requirements for NMS Stock ATSS might cause some NMS Stock ATSS to cease operations, which could result in reduced competition among and between NMS Stock ATSS. If it is the case that the NMS Stock ATSS that face the highest cost of disclosure are the ones that have worse execution quality, the surviving NMS Stock ATSS might enhance execution quality and may allow market participants to transact at lower prices. If order flow is directed towards these surviving NMS Stock ATSS after the trading venues that face the highest cost of disclosure cease operations, then a smaller number of surviving trading venues might mean that there would be a higher likelihood that the orders of buyers and sellers on an NMS Stock ATS would interact and execute, which could improve liquidity. Even if some of the order flow from NMS Stock ATSS that cease operations does not migrate to the surviving NMS Stock ATSS, but migrates towards national securities exchanges, greater order interaction between buyers and sellers on a national securities exchange might be fostered, thereby improving price discovery. Moreover, because some NMS Stock ATSS operate as crossing networks and derive their prices from national securities exchanges, greater price discovery on a national securities exchange could spill over to affect the execution prices on the surviving NMS Stock ATSS and thereby potentially reduce market participants' trading costs. Additionally, given the fairly standardized set of information that would be publicly disclosed on proposed Form ATS-N and that trading in the market by NMS Stock ATSS may in fact be concentrated on fewer NMS Stock ATSS as a result of this proposal, market participants may process, and react more quickly to, information pertaining to changes in an

NMS Stock ATS's operations when evaluating potential trading venues. As such, the proposed amendments to Regulation ATS might improve market efficiency.

Alternatively, heightened disclosure requirements pertaining to the public disclosure of proposed Form ATS-N could have a contrary effect, by increasing market participants' trading costs relative to the baseline. Institutional investors may use NMS Stock ATSs in an attempt to minimize the price impact of their trades. Even though the size of the average order on NMS Stock ATSs has been shown to be roughly equivalent to that on national securities exchanges, smaller orders on NMS Stock ATSs can be the result of shredding larger orders.<sup>808</sup> Preventing information regarding those orders from becoming public can minimize adverse price moves that may occur when proprietary traders learn that there may be large buyers or sellers in the market. Thus, NMS Stock ATSs represent a tool for institutional investors to help control information leakage. If some NMS Stock ATSs exit the market as a result of the proposed amendments, there could be a reduction in the number of trading platforms that allow institutional investors to control their price impact costs. Institutional investors, who would have traded on these NMS Stock ATSs if they did not exit the market, may now have to trade on other trading venues, such as other NMS Stock ATSs or national securities exchanges. If institutional investors execute their orders on a national securities exchange, they may have to absorb price impact costs, because national securities exchanges may not offer a means for reducing these costs. Insofar that an NMS Stock ATS's competitive advantage is driven by its matching methodology or other operational characteristics that are currently confidential, the Commission understands such disclosure could impact this competitive advantage. However, the Commission does not know

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<sup>808</sup> See Tuttle: ATS Trading in NMS Stocks, supra note 126.

the extent to which the proposal would affect an NMS Stock ATS's decision to continue operations or exit the market, and, therefore, cannot estimate the number of ATSs that may exit. Furthermore, the Commission does not have information in order for it to make reasonable assumptions about the fraction of displaced volume – from NMS Stock ATSs that would cease operations – that would be directed towards national securities exchanges, NMS Stock ATSs, or non-ATS OTC trading centers. Therefore, the Commission cannot estimate the impact that the proposal would have on an NMS Stock ATS's price impact costs.

The price impact cost institutional investors face on a national securities exchange is related to the depth of the market, and the depth of the market is often related to the market capitalization of a stock and its liquidity.<sup>809</sup> For instance, if an institutional investor were to trade a large capitalization stock on a national securities exchange as opposed to on an NMS Stock ATS, given that the large capitalization stock might be more liquid than a small capitalization stock, and thereby have greater market depth outside the inside quote, the institutional investor may suffer little difference in price impact costs by executing the order on a national securities exchange. On the other hand, a small capitalization, low priced stock might have much lower market depth outside the inside quote, and, therefore, the difference in price impact costs for executing orders of these stocks on an exchange might be substantial.<sup>810</sup> Furthermore, because NMS Stock ATSs trade larger dollar volume in small capitalization, low priced stocks, the price

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<sup>809</sup> A deep market is one in which larger orders do not have a much greater impact on prices than smaller orders. See Foucault, Pagano and Roell, 2013, "Market Liquidity," Oxford University Press.

<sup>810</sup> See Collver, Charles, 2014, "A Characterization of Market Quality for Small Capitalization US Equities," SEC Division of Trading and Markets Working Paper, available at [http://www.sec.gov/marketstructure/research/small\\_cap\\_liquidity.pdf](http://www.sec.gov/marketstructure/research/small_cap_liquidity.pdf).

impact costs for institutional investors that trade in such stocks may in fact be severe if many NMS Stock ATSS decided to exit the market.<sup>811</sup> As mentioned above, while the Commission is unable to estimate the number of NMS Stock ATSS that may potentially exit the market, the Commission also does not know whether firms will send their small capitalization stock orders to other surviving NMS Stock ATSS, national securities exchanges, or non-ATS trading centers. Therefore, the Commission cannot estimate what price market participants would receive for the small capitalization stock orders and thus, the Commission cannot estimate the price impact costs associated with these small capitalization stock orders.

### **3. Written Safeguards and Written Procedures to Protect Subscribers' Confidential Trading Information, and Proposed Recordkeeping Requirements**

The Commission is also proposing to amend existing Rules 301(b)(10)<sup>812</sup> and 303(a)(1)<sup>813</sup> of Regulation ATS to require all ATSS to adopt and preserve written safeguards and written procedures to protect subscribers' confidential trading information, as well as written oversight procedures to ensure those safeguards and procedures are followed. As explained above, the Commission preliminarily believes that these proposed amendments should both strengthen the effectiveness of ATS' safeguards and procedures and improve those ATSS' ability to implement and monitor the adequacy of, and the ATSS' compliance with, their safeguards and procedures.<sup>814</sup> Furthermore, the Commission preliminarily believes that requiring ATSS to adopt

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<sup>811</sup> The Commission notes that it is difficult to quantify the increase in price impact costs faced by institutional traders because it is unclear how many NMS Stock ATSS may cease operations, and more so, it is unclear whether these institutional traders who would like to execute large orders will route them to other ATSS that may continue to operate.

<sup>812</sup> See 17 CFR 242.301(b)(10).

<sup>813</sup> See 17 CFR 242.303(a).

<sup>814</sup> See supra Section IX.

written safeguards and written procedures will benefit the Commission by helping it better understand, monitor, and evaluate how each ATS protects subscribers' confidential trading information from unauthorized disclosure and access.<sup>815</sup> The Commission also expects that this proposed requirement will help oversight by the SRO of which the NMS Stock ATS's broker-dealer operator is a member.

Under Rule 301(b)(10), all ATSs must establish adequate safeguards and procedures to protect subscribers' confidential trading information and adequate oversight procedures to ensure that the safeguards and procedures established to protect such trading information are followed. However, neither Rule 301(b)(10) nor the recordkeeping requirements under Rule 303(a)(1) of Regulation ATS require that an ATS have and preserve those safeguards and procedures in writing. As explained above, the Commission preliminarily believes that the proposal to require written safeguards and written procedures would better enable ATSs – in particular, those ATSs that do not currently maintain written safeguards and procedures – to protect confidential subscriber trading information and implement and monitor the adequacy of, and the ATS's compliance with, its safeguards and procedures.<sup>816</sup>

The Commission is also proposing to amend the recordkeeping rules relevant to the proposed amendments to Rule 301 and proposed Rule 304. The Commission is proposing that NMS Stock ATSs shall preserve Form ATS-N, Form ATS-N Amendments, and a Form ATS-N notice of cessation for the life of the enterprise and any successor enterprise pursuant to Rule

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<sup>815</sup> See id.

<sup>816</sup> See id.

303(a)(2)<sup>817</sup> of Regulation ATS.<sup>818</sup> The Commission is also proposing to amend Rule 303(a)(1)<sup>819</sup> so that ATSS must preserve for a period of not less than three years, the first two in an easily accessible place, the written safeguards and procedures that would be required under the proposed amendments to Rule 301(b)(10). The Commission understands that these proposed amendments regarding recordkeeping requirements may require NMS Stock ATSS to set up systems and procedures, and these are expected to account for a portion of the implementation costs under this proposal.<sup>820</sup>

#### **D. Alternatives**

##### **1. Require NMS Stock ATSS to Publicly Disclose Current Form ATS**

One alternative would be to allow NMS Stock ATSS to continue to describe their operations on current Form ATS, but either make Form ATS public by posting on the Commission's website or require NMS Stock ATSS to publicly disclose their initial operation reports, amendments, and cessation of operations on Form ATS. Non-NMS Stock ATSS' Form ATS filings would continue to remain confidential.

Use of current Form ATS would lower the cost of compliance for current and future NMS Stock ATSS compared to compliance costs under the proposal. However, because the content of Form ATS would not change under this alternative, market participants would continue to receive limited information regarding how orders interact, match, and execute on

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<sup>817</sup> See 17 CFR 242.303(a)(2).

<sup>818</sup> The Commission notes that an NMS Stock ATS that had previously made filings on Form ATS would be required to preserve those filings for the life of the enterprise, as well as filings made going forward on Form ATS-N.

<sup>819</sup> See 17 CFR 242.303(a)(1).

<sup>820</sup> See supra Section XIII.C.1.

NMS Stock ATSs and the activities of NMS Stock ATSs' broker-dealer operators and their affiliates. Relative to the proposal, market participants' search costs in identifying which NMS Stock ATS may better serve their trading interests would increase. As a result, their trading costs may increase and the execution quality related to their orders may be reduced. The Commission expects public disclosure of Form ATS could have some harmful effects on the competitive dynamics of NMS Stock ATSs and result in some exiting the market. However, such effects would likely be smaller than those expected under the proposal because, under this alternative, Form ATS would require disclosure of less information about the operations of NMS Stock ATSs than the more expansive and granular information that NMS Stock ATSs would be required to disclose in Form ATS-N.

Requiring NMS Stock ATSs to publicly disclose initial operation reports, amendments, and cessation of operations on Form ATS would place NMS Stock ATSs under greater public scrutiny, which could improve the quality of the filings compared to the current baseline. Regulators' oversight of NMS Stock ATSs under this alternative would be similar to that under current Regulation ATS, so they would not be able to offer the same level of protection to market participants as under the proposal.

## **2. Require Proposed Form ATS-N But Deem Information Confidential**

Another alternative would be to require NMS Stock ATSs to file proposed Form ATS-N with the Commission but not make Form ATS-N publicly available. Proposed Form ATS-N would include detailed disclosures about the NMS Stock ATS's operations and the activities of its broker-dealer operator and its affiliates, and the Commission would declare filings on Form ATS-N either effective or ineffective.

This alternative would improve the quality of NMS Stock ATSs' disclosures to the Commission because proposed Form ATS-N would require more information about the operations of NMS Stock ATSs than is currently solicited on Form ATS. In addition, proposed Form ATS-N would require information about the activities of the broker-dealer operator and its affiliates, whereas current Form ATS does not require such information. This alternative, which would include a process for the Commission to determine whether an NMS Stock ATS qualifies for the exemption from the definition of "exchange," and declare a proposed Form ATS-N effective or ineffective, would strengthen the Commission's oversight of NMS Stock ATSs.

However, this alternative would not make NMS Stock ATSs' operations more transparent for market participants. The lack of public disclosure of the means of order interaction, display and routing practices by NMS Stock ATSs could result in market participants making less informed decisions regarding where to route their orders and therefore result in lower execution quality than they would obtain under the proposal. Additionally, this alternative would not reduce the search costs for subscribers to identify potential routing destinations for their orders. Because proposed Form ATS-N would not be publicly disclosed under this alternative, the level of competition between NMS Stock ATSs would stay the same, and the lack of transparency about an NMS Stock ATS's operations and activities of the broker-dealer operator and its affiliates would be expected to persist.

**3. Require NMS Stock ATSs to Publicly Disclose Proposed Form ATS-N But Not Declare Proposed Form ATS-N Effective or Ineffective**

Under this alternative, the Commission would require NMS Stock ATSs to file proposed Form ATS-N and would make it public, but the Commission would continue to use the current

notice regime instead of declaring Form ATS-N effective or ineffective. The Commission would not determine whether an NMS Stock ATS qualifies for the exemption from the definition of “exchange,” and would not declare proposed Form ATS-N filings effective or ineffective.

Benefits of maintaining the current notice regime would include a lower demand for Commission and its staff resources to determine whether an NMS Stock ATS qualifies for the exemption from the definition of “exchange” and whether the Commission should declare a proposed Form ATS-N effective or ineffective, and to assess whether the Commission should suspend, limit, or revoke the effectiveness of an NMS Stock ATS’s Form ATS-N. In addition, maintaining the current notice regime as opposed to declaring the proposed Form ATS-N effective or ineffective could be cost-effective to NMS Stock ATSs and could lower the barriers to entry for new NMS Stock ATSs compared to such barriers under the proposal.

Without a process to declare proposed Form ATS-N effective or ineffective, there would be less assurance that disclosures by NMS Stock ATSs would be accurate, current, and complete. Under this alternative, it would be more difficult for the Commission to exercise its oversight responsibilities with respect to the accuracy, currency, completeness and fair presentation of disclosures on proposed Form ATS-N than under the proposal, which would provide a process for the Commission to declare a proposed Form ATS-N effective or ineffective. Moreover, continued use of a notice regime could lessen the benefit of enhanced transparency relative to such benefit under the proposal and as a result, this alternative might not provide the same level of protection to market participants as the proposal.

#### **4. Initiate Differing Levels of Public Disclosure Depending on NMS Stock ATS Characteristics**

Under this alternative, the Commission would require different levels of disclosure among NMS Stock ATSS based on dollar trading volume. For instance, NMS Stock ATSS with lower transaction volumes would be subject to lower levels of disclosure on proposed Form ATS-N. As a result, their compliance costs would be lower, which could lower their entry barriers relative to such barriers under the proposal. Because these small NMS Stock ATSS would not have to disclose as much information pertaining to their operations, they could have more time to innovate without disclosing such innovation to competitors. This could allow these small NMS Stock ATSS to better compete with more established NMS Stock ATSS, national securities exchanges, and broker-dealers and put more competitive pressure on the market. Furthermore, reduced regulatory burdens for small NMS Stock ATSS may result in greater innovation relative to the proposal because these small NMS Stock ATSS would not have to be concerned about disclosing proprietary information. Greater innovation for small NMS Stock ATSS could give them a greater competitive advantage in attracting order flow relative to large NMS Stock ATSS. This competitive advantage for small NMS Stock ATSS could spill over to market participants who execute on these ATSS, by increasing the execution quality of their trades.

However, under this alternative, broker-dealer operators of NMS Stock ATSS could seek to allocate order flow to multiple NMS Stock ATSS operated by either the broker-dealer or its affiliates to avoid reaching threshold volumes that would trigger additional disclosure requirements. This could create some information opaqueness in the market, which could lead to lower execution quality for market participants relative to that under the proposal. The Commission notes, however, that although Regulation ATS currently has volume thresholds for

fair access and quote transparency requirements, the Commission has not observed any ATSS using such tactics to avoid crossing thresholds.

**5. Require NMS Stock ATSS to Register as National Securities Exchanges and Become SROs**

Under this alternative, the Commission would eliminate the exemption from the definition of “exchange” for NMS Stock ATSS under Exchange Act Rule 3a1-1(a) so that an NMS Stock ATS would be required to register as a national securities exchange and become an SRO. This alternative would provide market participants with the same protections that accompany the regulatory regime that applies to national securities exchanges. Without the benefit of the exemption from the definition of “exchange,” an NMS Stock ATS would be required, among other things, to file proposed rule changes publicly on Form 19b-4 and make publicly available its entire rule book. Moreover, as a national securities exchange, an NMS Stock ATS would not be allowed to have conflicts of interest that it can as an NMS Stock ATS. More information about the priority, order interaction, display, and execution procedures would help market participants make better informed decisions about where to route their orders for best execution. If most NMS Stock ATSS decided to register as national securities exchanges and some NMS Stock ATSS withdrew from the market and stopped operating, competition among and between these trading venues could increase, leading to greater market liquidity and market efficiency. Further, this alternative could strengthen Commission oversight, thus benefitting market participants.

While NMS Stock ATSS would no longer need to register as broker-dealers or comply with Regulation ATS, registration as national securities exchanges would create high startup costs and high ongoing operational costs compared to what they would incur under the

proposal.<sup>821</sup> Under this alternative, these new national securities exchanges, which would be SROs, would, among other things, be required to comply with Section 6 of the Exchange Act. Because national securities exchange are SROs, a new national securities exchange would bear certain regulatory costs that are higher than those associated with registering as a broker-dealer. For example, a national securities exchange would bear expenses associated with joining the national market system plans and surveilling trading activity and member conduct on the exchange.<sup>822</sup>

#### **6. Discontinue Quarterly Volume Reports on Form ATS-R**

Another alternative would be to amend Regulation ATS so that NMS Stock ATSs would no longer be required to file quarterly volume reports on Form ATS-R because, as noted above, FINRA rules currently require ATSs that transact in NMS stocks to report aggregate weekly volume information and the number of trades to FINRA in certain equity securities, including NMS stocks.<sup>823</sup>

Instead, NMS Stock ATSs would be required to disclose, in quarterly amendments to Form ATS-N, the information that is currently captured by Form ATS-R that is not captured by FINRA reporting requirements. The Commission notes that, in addition to requiring unit volume

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<sup>821</sup> Newly registered national securities exchanges must establish appropriate surveillance and disciplinary mechanisms, and as a result incur start-up costs associated with such obligations, such as writing a rule book. See Regulation ATS Adopting Release, supra note 7, at 70897. Furthermore, the cost of acquiring the necessary assets and the operating funds to carry out the day-to-day functions of a national securities exchange are significant. See id.

<sup>822</sup> See Regulation NMS Adopting Release, supra note 7, at 70903.

<sup>823</sup> Each ATS is also required to use a unique MPID in its reporting to FINRA, such that its volume reporting is distinguishable from other transaction volume reported by the broker-dealer operator of the ATS.

of transactions, Form ATS-R, which is “deemed confidential when filed,”<sup>824</sup> requires ATSS to report dollar volume of transactions during the quarter, a list of all subscribers that were participants on the ATS during the quarter, a list of all securities that were traded on the ATS during the quarter, and, if the ATS is subject to fair access requirements under Rule 301(b)(5), information about all persons that were granted, denied or limited access during the quarter.

The benefit of this alternative would be that NMS Stock ATSS would no longer be required to report quarterly on Form ATS-R information that is otherwise available. In addition, information that is currently deemed confidential on Form ATS-R would be made publicly available in quarterly amendments to Form ATS-N. NMS Stock ATSS would, however, be required to submit such quarterly amendments, which an NMS Stock ATS would not otherwise be required to do if the NMS Stock ATS did not have any other material changes to report during the quarter.

The Commission does not believe that this alternative would create significant new costs in preparing a quarterly Form ATS-N because the costs would be comparable to the costs of preparing Form ATS-R. However, as a result of the effective merging of proposed Form ATS-N and current Form ATS-R under this alternative, some of the information that would be made public on proposed Form ATS-N, such as the ATS’s subscriber list and the list of persons granted, denied, or limited access during the reporting period (which is not being solicited under the proposed Form ATS-N) could be proprietary. Making such information public could harm the NMS Stock ATS as well as persons denied access.

#### **7. Require NMS Stock ATSS to Operate as Limited Purpose Entities**

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<sup>824</sup> See 17 CFR 242.301(b)(2)(vii).

Another alternative would be to amend Regulation ATS to require an NMS Stock ATS to operate as a “stand-alone” entity, which would exist only to operate the ATS and have no affiliation with any broker-dealer that seeks to execute proprietary or agency orders on the NMS Stock ATS. Under this alternative, NMS Stock ATSs would be required to publicly disclose proposed Form ATS-N, proposed Form ATS-N Amendments, and notices of cessation on proposed Form ATS-N, and would be limited purpose entities that could not engage in any activities other than operation of the ATS. This alternative would prohibit the broker-dealer operator of the NMS Stock ATS from engaging in any other broker-dealer activity, and would consequently prohibit the operation of an NMS Stock ATS by a multi-service broker-dealer.

The benefit of this alternative would be to eliminate potential conflicts of interest by requiring a broker-dealer that operates an NMS Stock ATS to have only a single business function, namely, operating the ATS. The broker-dealer would be required to eliminate any other functions, such as trading on a proprietary basis or routing customer orders.

However, this alternative may discourage broker-dealers from creating and operating innovative NMS Stock ATS platforms, and instead drive them to execute their own proprietary trades internally on their other broker-dealer systems. In addition, if they were no longer able to trade on a proprietary basis or route customer orders to their own NMS Stock ATS, many broker-dealers may choose to file a cessation of operations report and shut down the operations of their NMS Stock ATS.<sup>825</sup> Shutting down their NMS Stock ATS operations could result in

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<sup>825</sup> Alternatively, current broker-dealer operators of ATSs that trade NMS stocks may choose to spin-off or sell their ATS rather than cease operations. The expected number of broker-dealer operators selling their ATSs at once could affect the value the broker-dealer operator could receive from the sale and, as such, could factor into the decision of whether to spin-off, sell, or fold their ATS.

similar (though potentially more severe) effects on the competitive dynamics of the ATS market as under the proposal. This could push more liquidity to less transparent venues (i.e., non-ATS OTC trading centers) or could result in more liquidity moving to national securities exchanges. The remaining NMS Stock ATSS, which would likely be fewer in number as some broker-dealer operators choose to cease operations of the ATSS, could become popular trading destinations because the absence of conflicts of interest could encourage market participants to route orders to those trading centers. Market participants would likely still have a need for anonymous trading, which could further contribute to liquidity still flowing to the stand-alone NMS Stock ATSS. Thus, if multi-service broker-dealers that operate their own NMS Stock ATS cease operating the ATSS, liquidity might move to other trading venues, including both transparent venues, such as national securities exchanges, and less transparent venues, such as non-ATS OTC trading centers. On the other hand, cessation of operations of NMS Stock ATSS owned by multi-service broker dealers could also result in stand-alone NMS Stock ATSS, which would not have the potential conflicts of interest discussed above, attracting more liquidity.

#### **8. Lower the Fair Access Threshold for NMS Stock ATSS**

As discussed above, NMS Stock ATSS are not required to provide fair access to the services of the NMS Stock ATS unless the ATS reaches the 5% trading volume threshold in a stock under Rule 301(b)(5) of Regulation ATS.<sup>826</sup> As an alternative to the proposed enhancements to the conditions to the exemption from the definition of “exchange” pursuant to Rule 3a1-1(a) for NMS Stock ATSS, which would include NMS Stock ATSS making the disclosures required by Form ATS-N so that market participants could make more informed

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<sup>826</sup> See supra notes 92-95 and accompanying text.

decisions about an NMS Stock ATS as a potential trading venue,<sup>827</sup> the Commission considered lowering the fair access threshold under Rule 301(b)(5) of Regulation ATS<sup>828</sup> for NMS Stock ATSs to a level sufficiently low such that most NMS Stock ATSs would be prohibited from engaging in many discriminatory practices.<sup>829</sup>

One of the principal aims of this proposed rulemaking is to provide market participants with more information about the activities of the broker-dealer operator, its affiliates, and the operations of the NMS Stock ATS, so they may better assess NMS Stock ATSs as potential trading venue for their orders. For example, as discussed above, the Commission is concerned that market participants have limited or different levels of information about how the NMS Stock ATSs operate, and the activities of broker-dealer operators and their affiliates.<sup>830</sup> The Commission could propose new rules that would expressly prohibit or limit organizational structures that might raise conflicts of interest, or could expressly prohibit or limit the manner by which an ATS discriminates among or between subscribers. Lowering the threshold that triggers the fair access requirements would be one of the means of prohibiting or limiting certain discriminatory practices.

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<sup>827</sup> As discussed above Sections VII and VIII, the information that would be disclosed on Form ATS-N would include, among other things, whether different classes of subscribers or persons have differing access to the services of the ATS.

<sup>828</sup> 17 CFR 242.301(b)(5).

<sup>829</sup> As discussed above in Section VII.B., the requirements of Rule 301(b)(5) that prohibit or limit discriminatory practices of ATSs only apply to NMS Stock ATSs that cross the fair access threshold, and then, apply only with respect to the NMS stocks in which an ATS crosses the threshold.

<sup>830</sup> See supra Section III.C.

The Commission preliminarily believes that lowering the fair access threshold for NMS Stock ATSS would require the Commission to consider lowering the fair access threshold to zero, or to some threshold between zero and 5%. If the fair access threshold remained at a threshold above zero, the benefit of this approach, as compared to the proposed disclosure requirements that would apply to all NMS Stock ATSS, could be further limited by the fact that the fair access requirements would apply only to the NMS stocks for which the NMS Stock ATSS had crossed the fair access threshold. The Commission could address that situation by proposing further amendments to the fair access requirements that would extend an ATSS's fair access duties to all NMS stocks once the fair access threshold had been crossed by an ATSS in a certain number of NMS stocks, to revise the duties incurred when the threshold is crossed, or to simply lower the threshold to zero, which would have the effect of requiring all NMS Stock ATSS to immediately comply with the fair access requirements for all NMS stocks. However, the Commission preliminarily believes that the disclosures that would be required by proposed Form ATSS-N requirements would be a cost effective and simpler approach than proposing fundamental revisions to the fair access requirements that would achieve the aim of providing market participants with information to better assess NMS Stock ATSS as potential trading venues.

**9. Apply Proposed Rule 304 to ATSS that Trade Fixed Income Securities and ATSS that Solely Trade Government Securities**

Another alternative would be to amend Regulation ATSS to require ATSS that trade fixed income securities and ATSS that solely trade government securities to also report information about their operations and activities of the broker-dealer operator and affiliates on Form ATSS-N. Under this alternative, NMS Stock ATSS, as well as ATSS that trade fixed income securities and ATSS that solely trade government securities, would be required to publicly disclose proposed

Form ATS-N, proposed Form ATS-N Amendments, and notices of cessation on proposed Form ATS-N.

The benefit of this alternative is that it may provide market participants with clearer transparency regarding the operations and activities of all types of ATSS, not just NMS stock ATSS. To the extent that there may be market participants who predominately trade orders of NMS stock, fixed income securities, and government securities on ATSS, these market participants would benefit from the added transparency regarding how these venues operate and the activities of their broker-dealer operators and affiliates.

ATSS that effect trades in fixed income securities primarily compete against other trading venues with limited or no operational transparency requirements or standards. This is not the case with NMS Stock ATSS, which provide limited information to market participants about their operations and compete directly with national securities exchanges, which are required to publicly disclose information about their operations in the form of proposed rule changes and a public rule book.<sup>831</sup> With government securities, trading occurs in bilateral transactions or on centralized electronic trading platforms that generally operate with limited transparency.<sup>832</sup> Because the market structure for and transparency requirements related to trading each of these types of securities (NMS Stock ATSS, fixed income, government securities) differ, Form ATS-N under this alternative would need to include different or additional disclosure requirements related to the operations and activities of each of these types of ATSS, so as to capture the nuances in each particular market. As a result, Form ATS-N under this alternative would need to

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<sup>831</sup> See Section IV.B.

<sup>832</sup> See id.

be much more complex than the proposed Form ATS-N, increasing the costs for investors to efficiently use Form ATS-N for a given type of security trading and for NMS Stock ATSS, reducing the benefits from Form ATS-N in NMS stocks. In addition, fixed income ATSS would incur costs to comply with the additional disclosures, which could result in an exit of existing fixed income ATSS, discourage innovation in surviving fixed income ATSS, and increase barriers to entry for new fixed income ATSS. Because the corporate and municipal fixed income markets lack much of the automation present for venues that trade NMS stocks, such costs could be more critical in the development of the fixed income market than in the markets for NMS stocks. Furthermore, as discussed above, ATSS that solely trade government securities are exempt from compliance with Regulation ATS.<sup>833</sup> To the extent that this exemption is removed and such ATSS were required to comply with Regulation ATS, including proposed Rule 304, these ATSS would incur costs associated with the public reporting and recordkeeping requirements of Regulation ATS.

Request for Comment on the Economic Analysis

The Commission is sensitive to the potential economic effects, including the costs and benefits, of the proposed amendments to Regulation ATS. The Commission has identified above certain costs and benefits associated with the proposal and requests comment on all aspects of its preliminary economic analysis. The Commission encourages commenters to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such costs or benefits. In particular, the Commission seeks comment on the following:

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<sup>833</sup> See supra note 64.

506. Do you believe the Commission's analysis of the potential effects of the proposed amendments to Regulation ATS is reasonable? Why or why not? Please explain in detail.
507. Do you believe the Commission's assessment of the baseline for the economic analysis is reasonable? Why or why not? Please explain in detail.
508. Do you believe that the proposing release provides a fair representation of current practices and how those current practices would change under the proposed amendments to Regulation ATS? Why or why not? Please explain in detail.
509. Do you believe that the Commission has reasonably described how the competitive landscape for the market for NMS stock execution services would be affected under the proposed amendments to Regulation ATS? Why or why not? Please explain in detail. Does the release discuss all relevant forms of competition and whether the proposal could alter them? If not, which additional forms of competition could the proposal impact and how? Please explain in detail.
510. Do you believe that the Commission has reasonably identified all market participants that would be affected by the proposed amendments to Regulation ATS? If so, why? If not, why not, and which market participants do you believe are not reasonably excluded or would be affected by the proposed amendments? Please explain in detail.
511. Do you believe that the Commission has reasonably described how market participants would be affected by the proposed amendments to Regulation ATS? Why or why not? Please explain in detail.

512. Do you believe that the Commission has reasonably described the information market participants currently receive? If so, why? If not, why not? Please explain in detail.
513. Do you believe that the Commission has reasonably described the benefits market participants would receive from the information that would be required to be disclosed by the proposed amendments to Regulation ATS? Why or why not? Please explain in detail.
514. Do you believe that market participants currently have all relevant information concerning the activities of the broker-dealer operator of the NMS Stock ATS and its affiliates as such activities relate to the NMS Stock ATS? Why or why not? Do you believe there is information that is not required in the proposed amendments to Regulation ATS that would be beneficial to market participants? If so, please describe that information and its benefits in detail. If not, why not? Please support your arguments.
515. Do you believe that market participants currently have all relevant information concerning the subscribers to the NMS Stock ATS where their orders are executed? Why or why not? Do you believe there is information that is not required in the proposed amendments to Regulation ATS that would be beneficial to market participants? If so, please describe that information and its benefits in detail. If not, why not? Please support your arguments.
516. Do you believe that market participants currently have all relevant information concerning the trading operations of the NMS Stock ATS where their orders are executed? Why or why not? Do you believe there is information that is not

required in the proposed amendments to Regulation ATS that would be beneficial to market participants? If so, please describe that information and its benefits in detail. If not, why not? Please support your arguments.

517. Do you believe that market participants currently have all relevant information concerning the services offered by the NMS Stock ATS where their orders are executed and their fee structures? Why or why not? Do you believe there is information that is not required in the proposed amendments to Regulation ATS that would be beneficial to market participants? If so, please describe that information and its benefits in detail. If not, why not? Please support your arguments.
518. Do you believe that market participants currently have all relevant information concerning the safeguards and procedures that NMS Stock ATSS have instituted to protect their confidential trading information? Why or why not? Is there information that is not required in the proposed amendments to Regulation ATS that would be beneficial to market participants? If so, please describe that information and its benefits in detail. If not, why not? Please support your arguments.
519. Do you believe that the Commission has reasonably described its analysis of the costs and benefits of each proposed amendment to Regulation ATS? Why or why not? Please explain in detail.
520. Do you believe that there are additional benefits or costs that could be quantified or otherwise monetized? Why or why not? If so, please identify these categories and, if possible, provide specific estimates or data.

521. Do you believe there are there any additional benefits that may arise from the proposed amendments to Regulation ATS? If so, what are such benefits? Please explain in detail.
522. Do you believe there are benefits described above that would not likely result from the proposed amendments to Regulation ATS? If so, please explain these benefits or lack of benefits in detail.
523. Do you believe there are any additional costs that may arise from the proposed amendments to Regulation ATS? If so, do you believe there are methods by which the Commission could reduce the costs imposed by the proposed amendments to Regulation ATS while still achieving the goals? Please explain in detail.
524. Do you believe there are any potential unintended consequences of the proposed amendments to Regulation ATS? If so, what are they? If not, why not?
525. Do you believe there are costs described above that would not likely result from the proposed amendments to Regulation ATS? Why or why not? Please support your arguments.
526. Do you believe that the proposing release appropriately describes the potential effects of the proposed amendments to Regulation ATS on the promotion of efficiency, competition, and capital formation? Why or why not? If possible, please provide analysis and empirical data to support your arguments on the competitive or anticompetitive effects, as well as the efficiency and capital formation effects, of the proposed amendments.

527. Do you believe that there are alternative mechanisms for achieving the Commission's goal of improving transparency of NMS Stock ATS's trading operations and regulatory oversight while promoting competition and capital formation? If so, what are such mechanisms? Please explain in detail.
528. Do you believe that market participants would change their behavior in response to the proposed amendments to Regulation ATS in any way? Why or why not? If so, which market participants would change their behavior and how? If not, why not? What would be the benefits and costs of these changes? How would these changes affect efficiency, competition, and capital formation? How would these changes affect market quality and market efficiency? Please support your arguments.
529. Do you believe there are benefits that may arise if the Commission were to apply proposed Rule 304, in whole or in part, to fixed income ATSS? If so, what are such benefits? Please explain in detail.
530. Do you believe there are costs that may arise if the Commission were to apply proposed Rule 304, in whole or in part, to fixed income ATSS? If so, what are such costs? Please explain in detail.
531. Do you believe that the proposed amendments could result in NMS Stock ATSS selecting to trade fixed income securities instead of NMS stocks, because, under the proposed amendments, Rule 304 would not apply to fixed income securities? Please explain in detail.
532. Do you believe that if the Commission were to apply proposed Rule 304 to fixed income ATSS, this could alter the nature of competition in the market for order

execution services for fixed income securities? Why or why not? Please support your arguments.

533. Do you believe that if the Commission were to apply proposed Rule 304 to fixed income ATSS, this could promote greater efficiency, competition, and capital formation relative to the current proposal? If so, please explain in detail.
534. Do you believe there are benefits that may arise if the Commission should adopt amendments to Regulation ATS to remove the exemption under Rule 301(a)(4)(ii)(A) of Regulation ATS for ATSS whose trading activity is solely in government securities? If so, what are such benefits? Please explain in detail.
535. Do you believe that there are benefits that may arise if the Commission enhances the transparency requirements applicable to ATSS that effect transactions solely in government securities? If so, what are such benefits? Please explain in detail.
536. Do you believe there are costs that may arise if the Commission adopted amendments to Regulation ATS to remove the exemption under Rule 301(a)(4)(ii)(A) of Regulation ATS for ATSS whose trading activity is solely in government securities? If so, what are such costs? Please explain in detail.
537. Do you believe that there are costs that may arise if the Commission were to apply Rule 304 to ATSS that effect transactions solely in government securities? If so, what are such costs? Please explain in detail.
538. Do you believe that the proposed amendments could result in ATSS selecting to solely trade government securities instead of NMS stocks, because, under the proposal, Rule 304 would not apply to government securities? Please explain in detail.

539. Do you believe that if the Commission were to apply Rule 304 to ATSS that solely trade government securities, this could alter the nature of competition in the market for order execution services for government securities? Why or why not? Please support your arguments.
540. Do you believe that if the Commission were to apply proposed Rule 304 to ATSS that solely trade government securities, this could promote greater efficiency, competition, and capital formation relative to the current proposal? If so, please explain in detail.
541. Do you believe that requiring NMS Stock ATSS to do something more to ensure compliance with proposed Rule 304 than the certification required under FINRA Rule 3130 would have effects on regulatory oversight and investor protection? If so, please explain in detail.
542. Do some NMS Stock ATSS currently disclose aggregate platform-wide order flow and execution statistics regarding the NMS Stock ATS that are not otherwise required disclosures under Exchange Act Rule 605 of Regulation NMS to one or more subscribers by the NMS Stock ATS? If so, what order flow and execution statistics are provided? How widely disseminated is the information? To what extent do the NMS Stock ATSS disclose how they calculate the statistics? Please explain in detail.
543. Do you believe that there are benefits to market participants from having NMS Stock ATSS publicly disclose aggregate platform-wide order flow and execution statistics regarding the NMS Stock ATS that are not otherwise required disclosures under Exchange Act Rule 605 of Regulation NMS but still published

or otherwise provided to one or more subscribers by the NMS Stock ATS, and from having NMS Stock ATSs describe how those statistics are calculated? If so, please explain in detail. Do you believe that there are costs to NMS Stock ATSs from having them publicly disclose those market quality statistics and describe how those statistics are calculated? If so, please explain in detail.

544. Do you believe that there are benefits to market participants if the Commission were to require NMS Stock ATSs to provide disclosure about their governance structure, compliance programs and controls to comply with Regulation ATS? If so, please explain in detail.

545. Do you believe that there are costs to NMS Stock ATSs if the Commission were to require them to provide disclosure about their governance structure, compliance programs and controls to comply with Regulation ATS? If so, please explain in detail.

546. Should proposed Form ATS-N be submitted or made publicly available on EDGAR instead of through the EFFS system and the Commission's website? What would be the advantages to the public or to NMS Stock ATSs of access through EDGAR instead of the Commission's proposed process?

547. Should some or all of the information in proposed Form ATS-N be submitted in a particular financial reporting language such as the FIX Protocol, eXtensible Business Reporting Language (XBRL), or some other open standard that is widely available to the public and at no cost? Should the Commission create a new taxonomy for submitting the information in proposed Form ATS-N?

548. Should the Commission require that some or all of the information in proposed Form ATS-N be tagged using standard electronic definitions of a particular taxonomy, and what would be the additional compliance costs associated with tagging the information?
549. Would requiring any of the information in the narrative responses to be submitted in a tagged format enhance the public's use of the data beyond the Commission's proposal? If so, how?
550. Could a format other than the one proposed to be accepted by the EDFS system reduce the burden on NMS Stock ATSS in filing the required disclosures with the Commission? For example, could a single machine-readable PDF reduce the filing burden on NMS Stock ATSS? If so, please identify the alternative format and the reduced filing burdens associated with it.
551. Should proposed Form ATS-N be structured in a more granular detail, and if so, how? In addition, how would the more granular detail enhance the public's use of the data beyond the Commission's proposal? What would be the costs of providing more granular detail?
552. Would the public's usability of the data be enhanced if it were structured in another format? If so, please identify the other format and describe how the public's use of the data would be enhanced by the other format. If possible, discuss factors about the other format such as how commonly available it is, whether it is viewer-independent, whether it is an open standard, how it has been adopted internationally and in other regulatory contexts, and how it supports document attachments or references as well as narrative and numeric data.

553. Do you believe that the Commission articulated all reasonable alternatives for the proposed amendments to Regulation ATS? If not, please provide additional alternatives and how their costs and benefits, as well as their potential impacts on the promotion of efficiency, competition, and capital formation, would compare to the proposed amendments.
554. Do you believe that the Commission has reasonably described the costs and benefits for the alternatives described above? If not, please provide more accurate descriptions of costs and benefits, including any data or statistics that support those costs and benefits.
555. Do you believe that the Commission has reasonably described the potential impacts on the promotion of efficiency, competition, and capital formation of the alternatives described above relative to the proposed amendments? If not, please explain in detail which impacts for which alternatives the Commission has not reasonably described, and support your arguments with any applicable data or statistics.
556. The Commission generally requests comment on the competitive or anticompetitive effects, as well as the efficiency and capital formation effects, of the proposed amendments to Regulation ATS on market participants if the proposed rules are adopted as proposed. Commenters should provide analysis and empirical data to support their views on the competitive or anticompetitive effects, as well as the efficiency and capital formation effects, of the proposed amendments to Regulation ATS.

557. The Commission generally requests comment on whether the benefits of the proposed amendments to Regulation ATS justify the costs. Please be specific and provide details. Commenters should provide analysis and empirical data to support their views on the benefits and costs of the proposed amendments to Regulation ATS.

558. Do you believe that the Commission has solicited the right set of information on proposed Form ATS-N, which will be made available to the public? Is there any other information the Commission should ask NMS Stock ATSS to provide on Form ATS-N? If so, please provide details.

#### **XIV. Consideration of Impact on the Economy**

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,<sup>834</sup> the Commission requests comment on the potential effect of the proposed amendments and Form ATS-N on the United States economy on an annual basis. The Commission also requests comment on any potential increases in costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

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<sup>834</sup> 5 U.S.C. 603.

## XV. Regulatory Flexibility Act Certification

Section 3(a) of the Regulatory Flexibility Act of 1980<sup>835</sup> ("RFA") requires the Commission to undertake an initial regulatory flexibility analysis of the impact of the proposed rule amendments on small entities unless the Commission certifies that the rule, if adopted, would not have a significant economic impact on a substantial number of small entities.<sup>836</sup> For purposes of Commission rulemaking in connection with the RFA,<sup>837</sup> a small entity includes a broker or dealer that: (1) had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,<sup>838</sup> or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization.<sup>839</sup> With regard to national securities exchanges, a small entity is

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<sup>835</sup> 5 U.S.C. 603(a).

<sup>836</sup> 5 U.S.C. 605(b).

<sup>837</sup> Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term "small entity" for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10 under the Exchange Act, 17 CFR 240.0-10. See Exchange Act Release No. 18451 (January 28, 1982), 47 FR 5215 (February 4, 1982) (File No. AS-305).

<sup>838</sup> 17 CFR 240.17a-5(d).

<sup>839</sup> See 17 CFR 240.0-10(c). See also 17 CFR 240.0-10(i) (providing that a broker or dealer is affiliated with another person if: (1) Such broker or dealer controls, is controlled by, or is under common control with such other person; a person shall be deemed to control another person if that person has the right to vote 25 percent or more of the voting securities of such other person or is entitled to receive 25 percent or more of the net profits of such other person or is otherwise able to direct or cause the direction of the

an exchange that has been exempt from the reporting requirements of Rule 601 under Regulation NMS, and is not affiliated with any person (other than a natural person) that is not a small business or small organization.<sup>840</sup>

All ATSS, including NMS Stock ATSS, would continue to have to register as broker-dealers.<sup>841</sup> The Commission examined recent FOCUS data for the 46 broker-dealers that currently operate ATSS that trade NMS stocks and concluded that 1 of the broker-dealer operators of ATSS that currently trade NMS stock had total capital of less than \$500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter).<sup>842</sup> The Commission notes that this broker-dealer operator has never reported any transaction volume in any security, including NMS stock, to the Commission on Form ATS-R. Given that this particular ATS has never reported any transaction volume to the Commission over the six years since it first submitted its Form ATS to the Commission, the Commission preliminarily believes that this ATS would likely not submit a Form ATS-N if the proposed amendments to Regulation ATS are adopted. Consequently, the Commission certifies that the proposed amendments to

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management or policies of such other person; or (2) Such broker or dealer introduces transactions in securities, other than registered investment company securities or interests or participations in insurance company separate accounts, to such other person, or introduces accounts of customers or other brokers or dealers, other than accounts that hold only registered investment company securities or interests or participations in insurance company separate accounts, to such other person that carries such accounts on a fully disclosed basis).

<sup>840</sup> See 17 CFR 240.0-10(e). The Commission notes that while national securities exchanges can operate an ATS, subject to certain conditions, such an ATS would have to be registered as a broker-dealer. See Regulation ATS Adopting Release, *supra* note 7, at 70891. Currently, no national securities exchange operates an ATS that trades NMS stocks.

<sup>841</sup> 17 CFR 242.301(b)(1).

Regulation ATS would not, if adopted, have a significant economic impact on a substantial number of small entities.

The Commission encourages written comments regarding this certification. The Commission solicits comment as to whether the proposed amendments could have impacts on small entities that have not been considered. The Commission requests that commenters describe the nature of any impacts on small entities and provide empirical data to support the extent of such effect. Such comments will be placed in the same public file as comments on the proposed amendments to Regulation ATS. Persons wishing to submit written comments should refer to the instructions for submitting comments in the front of this release.

## **XVI. Statutory Authority and Text of Proposed Amendments**

Pursuant to Exchange Act, 15 U.S.C. 78a et seq., and particularly Sections [3(b), 5, 6, 11A, 15, 17(a), 17(b), 19, 23(a), and 36 thereof (15 U.S.C. 78c, 78k-1, 78o, 78q(a), 78q(b), 78w(a), and 78mm)], the Commission proposes to adopt Form ATS-N under the Exchange Act, to amend Rule 3a1-1 and Regulation ATS under the Exchange Act, and to amend 17 CFR 200.30-33.

### **List of Subjects in 17 CFR Parts 240, 242 and 249**

Brokers; Confidential business information; Fraud; Reporting and recordkeeping requirements; and Securities.

For the reasons stated in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

### **PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1934**

1. The authority citation for part 240 continues to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78dd; 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1376 (2010), unless otherwise noted.

\* \* \* \* \*

2. Amending Section 240.3a1-1 by:

- a. Changing the reference in paragraph (a)(2) from “17 CFR 242.303” to “17 CFR 242.304”.

- b. Changing the reference in paragraph (a)(3) from “17 CFR 242.303” to “17 CFR 242.304”.

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**PART 242 – REGULATIONS M, SHO, ATS, AC, NMS AND SCI AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES**

3. The authority citation for part 242 continues to read as follows:

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k-1(c), 78l, 78m, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd-1, 78mm, 80a-23, 80a-29, and 80a-37.

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4. Amend § 242.300 by:

- a. In paragraph (f) adding the phrase “the broker-dealer of” before the two instances of the phrase “an alternative trading system.”
- b. In paragraph (f)(2), adding the phrase “the broker-dealer of” before the phrase “the alternative trading system.”
- c. In paragraph (f)(3), adding the phrase “the broker-dealer of” before the phrase “the alternative trading system.”
- d. Adding paragraph (k) to read as follows:

§ 242.300 Definitions.

\* \* \* \* \*

(k) NMS Stock ATS means an alternative trading system, as defined in § 242.300(a), that facilitates transactions in NMS stocks, as defined in § 242.300(g).

5. Amend § 242.301 by:

- a. In paragraph (b)(2)(i), removing the phrase “, or if the alternative trading system is operating as of April 21, 1999, no later than May 11, 1999”;
- b. In paragraph (b)(2)(vii), removing the phrase “Market Regulation, Stop 10-2” and in its place adding “Trading and Markets” after the words “Division of”;
- c. Adding paragraph (b)(2)(viii);
- d. In paragraph (b)(9)(i), adding the word “Separately” before the word “File” and changing the first letter of the word “File” to lower case and adding the phrase “for transactions in NMS stocks, as defined in § 242.300(g), and transactions in securities other than NMS stocks” after the phrase “(§ 249.638 of this chapter)”;
- e. In paragraph (b)(9)(ii), adding the word “Separately” before the word “File” and changing the first letter of the word “File” to lower case and adding the phrase “for transactions in NMS stocks and transactions in securities other than NMS stocks” after the phrase “required by Form ATS-R”;
- f. In paragraph (b)(10), adding the word “Written” before the phrase “Procedures to ensure the confidential treatment of trading information” and changing the first letter of the word “Procedures” to lower case;
- g. In paragraph (b)(10)(i), adding the word “written” before the word “safeguards” in both instances and adding the word “written” before the word “procedures” in both instances; and
- h. In paragraph (b)(10)(ii), adding the word “written” before the word “oversight” and adding the word “written” before the word “safeguards”.

The addition reads as follows:

§ 242.301 Requirements for alternative trading systems.

\* \* \* \* \*  
(b) \* \* \* \* \*  
(2) \* \* \* \* \*

(viii) An alternative trading system that is an NMS Stock ATS shall file the reports and amendments required by § 242.304, and shall not be subject to the requirements of this paragraph (b)(2). An alternative trading system that effects transactions in both NMS stocks and non-NMS stocks shall be subject to the requirements of § 242.304 of this chapter with respect to NMS stocks and this paragraph (b)(2) with respect to non-NMS stocks.

6. Amend § 242.303 by:
  - a. In paragraph (a), removing the phrase “(b)(9)” and add the phrase “(b)(8)” after the word “paragraph”;
  - b. Adding paragraph (a)(1)(v);
  - c. In paragraph (a)(2)(ii), adding the phrase “or § 242.304” after the phrase “paragraph (b)(2) of § 242.301.”

The addition reads as follows:

§ 242.303 Record preservation requirements for alternative trading systems.

\* \* \* \* \*  
(a) \* \* \* \* \*  
(1) \* \* \* \* \*

(v) At least one copy of the written safeguards and written procedures to protect subscribers’ confidential trading information and the written oversight procedures created in the course of complying with paragraph (b)(10) of § 242.301.

7. Add § 242.304 to read as follows:

**§ 242.304 NMS Stock ATSS**

(a) Conditions to the Exemption. Unless not required to comply with Regulation ATS pursuant to § 242.301(a), an NMS Stock ATS must comply with 17 CFR 242.300-304 (except § 242.301(b)(2)) to be exempt from the definition of an exchange pursuant to § 240.3a1-1(a)(2).

(1) Form ATS-N.

(i) Filing. No exemption from the definition of “exchange” is available to an NMS Stock ATS pursuant to § 240.3a1-1(a)(2) unless the NMS Stock ATS files with the Commission a Form ATS-N, in accordance with the instructions therein, and the Commission declares the Form ATS-N effective. If the NMS Stock ATS is operating pursuant to a previously filed initial operation report on Form ATS as of the effective date of § 242.304, such NMS Stock ATS shall file with the Commission a Form ATS-N, in accordance with the instructions therein, no later than 120 calendar days after the effective date of § 242.304. An NMS Stock ATS operating as of the effective date of § 242.304 may continue to operate pursuant to a previously filed initial operation report on Form ATS pending the Commission’s review of the filed Form ATS-N.

(ii) Review Period and Extension of the 120-Day Review Period.

(A) The Commission will declare a Form ATS-N filed by an NMS Stock ATS operating as of the effective date of § 242.304 effective or ineffective no later than 120 calendar days from filing with the Commission. The Commission may extend the Form ATS-N review period for an NMS Stock ATS operating as of the effective date of § 242.304 for: (1) an additional 120 calendar days if the Form ATS-N is unusually lengthy or raises novel or complex issues that require additional time for review, in which case the Commission will notify the NMS Stock ATS in writing within the initial 120-day review period and will briefly describe the reason for

the determination for which additional time for review is required; or (2) any extended review period to which a duly-authorized representative of the NMS Stock ATS agrees in writing.

(B) The Commission will declare a Form ATS-N filed by an NMS Stock ATS that was not operating as of the effective date of § 242.304 effective or ineffective no later than 120 calendar days from filing with the Commission. The Commission may extend the Form ATS-N review period for: (1) an additional 90 days, if the Form ATS-N is unusually lengthy or raises novel or complex issues that require additional time for review, in which case the Commission will notify the NMS Stock ATS in writing within the initial 120-day review period and will briefly describe the reason for the determination for which additional time for review is required; or (2) any extended review period to which a duly-authorized representative of the NMS Stock ATS agrees in writing.

(iii) Effectiveness. The Commission will declare effective a Form ATS-N if the NMS Stock ATS qualifies for the Rule 3a1-1(a)(2) exemption. The Commission will declare ineffective a Form ATS-N if it finds, after notice and opportunity for hearing, that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors.

(iv) Order Regarding Effectiveness. The Commission will issue an order to declare a Form ATS-N effective or ineffective. Upon the effectiveness of the Form ATS-N, the NMS Stock ATS may operate pursuant to the conditions of this section. If the Commission declares a Form ATS-N ineffective, the NMS Stock ATS shall be prohibited from operating as an NMS Stock ATS. A Form ATS-N declared ineffective would not prevent the NMS Stock ATS from subsequently filing a new Form ATS-N.

(2) Form ATS-N Amendment.

(i) Form ATS-N Amendment Filing Requirements. An NMS Stock ATS shall amend an effective Form ATS-N, in accordance with the instructions therein:

(A) At least 30 calendar days prior to the date of implementation of a material change to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that are subject to disclosure on Form ATS-N;

(B) Within 30 calendar days after the end of each calendar quarter to correct any other information that has become inaccurate for any reason and has not been previously reported to the Commission as a Form ATS-N Amendment; or

(C) Promptly, to correct information in any previous disclosure on Form ATS-N, after discovery that any information filed under paragraphs (a)(1)(i) or (a)(2)(i)(A) or (B) of this section was inaccurate or incomplete when filed.

(ii) Commission Review. The Commission will, by order, if it finds that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors, declare ineffective any Form ATS-N Amendment filed pursuant to § 242.304(a)(2)(i)(A)-(C) no later than 30 calendar days from filing with the Commission. If the Commission declares a Form ATS-N Amendment ineffective, the NMS Stock ATS shall be prohibited from operating pursuant to the ineffective Form ATS-N Amendment. A Form ATS-N Amendment declared ineffective would not prevent the NMS Stock ATS from subsequently filing a new Form ATS-N Amendment.

(3) Notice of Cessation. An NMS Stock ATS shall notice its cessation of operations on Form ATS-N at least 10 business days before the date the NMS Stock ATS ceases to operate as an NMS Stock ATS. The notice of cessation shall cause the Form ATS-N to become ineffective on the date designated by the NMS Stock ATS.

(4) Suspension, Limitation, and Revocation of the Exemption from the Definition of Exchange.

(i) The Commission will, by order, if it finds, after notice and opportunity for hearing, that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors, suspend for a period not exceeding twelve months, limit, or revoke an NMS Stock ATS's exemption from the definition of "exchange" pursuant to § 240.3a1-1(a)(2).

(ii) If an NMS Stock ATS's exemption is suspended or revoked pursuant to paragraph (i), the NMS Stock ATS shall be prohibited from operating pursuant to the exemption from the definition an "exchange" pursuant to § 240.3a1-1(a)(2). If an NMS Stock ATS's exemption is limited pursuant to paragraph (i), the NMS Stock ATS shall be prohibited from operating in a manner otherwise inconsistent with the terms and conditions of the Commission order.

(b) Public Disclosures.

(1) Every Form ATS-N filed pursuant to § 242.304 shall constitute a "report" within the meaning of sections 11A, 17(a), 18(a), and 32(a) (15 U.S.C. 78k-1, 78q(a), 78r(a), and 78ff(a)), and any other applicable provisions of the Act.

(2) The Commission would make public via posting on the Commission's website, each:

(A) Order of effectiveness of a Form ATS-N;

(B) Order of ineffectiveness of a Form ATS-N;

(C) Effective Form ATS-N;

(D) Filed Form ATS-N Amendment;

(E) Order of ineffectiveness of a Form ATS-N Amendment;

(F) Notice of cessation; and

(G) Order suspending, limiting, or revoking the exemption from the definition of an

“exchange” pursuant to § 240.3a1-1(a)(2).

(3) Each NMS Stock ATS shall make public via posting on its website a direct URL hyperlink to the Commission’s website that contains the documents enumerated in (b)(2).

(c) Form ATS-N Filing Requirements.

(1) A filed Form ATS-N must respond to each item, as applicable, in detail and disclose information that is accurate, current, and complete.

(2) Any report required to be filed with the Commission under § 242.304 shall be filed electronically on Form ATS-N, and include all information as prescribed in Form ATS-N and the instructions thereto and contain an electronic signature. The signatory to an electronically filed Form ATS-N shall manually sign a signature page or document, in the manner prescribed by Form ATS-N, authenticating, acknowledging, or otherwise adopting his or her signature that appears in typed form within the electronic filing. Such document shall be executed before or at the time Form ATS-N is electronically filed and shall be retained by the NMS Stock ATS in accordance with § 242.303.

\* \* \* \* \*

**PART 249 - FORMS, SECURITIES EXCHANGE ACT OF 1934**

8. The general authority citation for part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a *et seq.* and 7201 *et seq.*; 12 U.S.C. 5461 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

9. Amending Subpart G, to add § 249.640 to read as follows:

**§ 249.640. Form ATS-N, information required of NMS Stock ATSs pursuant to § 249.304(a) of this chapter.**

This form shall be used by every NMS Stock ATS to file required reports under § 249.304(a) of this chapter.

**Note: The text of Form ATS-N will not appear in the Code of Federal Regulations.**

United States Securities and Exchange Commission  
Washington, DC 20510  
FORM ATS-N

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE  
CRIMINAL VIOLATIONS.  
See 18 U.S.C.1001 and 15 U.S.C. 78ff(a)

Page 1 of \_\_\_\_\_

File No: ATSN-[acronym]-YYYY-####

(Entity name) is making this filing pursuant to the Rule 304 under the Securities Exchange Act of 1934

- Initial Form Filing  
 Withdrawal of Initial Form Filing

**Submission Type (select one)**

- Rule 304(a)(1)(i) Form ATS-N  
 Rule 304(a)(2)(i)(A) Material Amendment to Form ATS-N  
 Rule 304(a)(2)(i)(B) Periodic Amendment to Form ATS-N  
 Rule 304(a)(2)(i)(C) Correcting Amendment to Form ATS-N  
 Rule 304(a)(3) Notice of Cessation

Date NMS Stock ATS will cease to operate: mm/dd/yyyy

Provide a brief narrative description of the Amendment:

**Part I: Name**

1. Full Name of Registered Broker-Dealer of the NMS Stock ATS ("broker-dealer operator") as stated on Form BD: \_\_\_\_\_
2. Full Name of NMS Stock ATS under which business is conducted, if any: \_\_\_\_\_
3. Market Participant Identifier (MPID) of the NMS Stock ATS: \_\_\_\_\_
4. Is the NMS Stock ATS currently operating pursuant to a previously filed initial operation report on Form ATS? Yes  No

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**Part II – Broker Dealer Operator Registration and Contact Information**

1. Effective date of broker-dealer registration with the Commission: mm/dd/yyyy
2. SEC File No.: 8-\_\_\_\_\_
3. CRD No.: \_\_\_\_\_
4. Full Name of the national securities association and the effective date of broker-dealer membership with the national securities association:

Name \_\_\_\_\_ mm/dd/yyyy

5. Legal Status (select one)

- Sole Proprietorship
- Corporation
- Partnership
- Limited Liability Company
- Other (Specify): \_\_\_\_\_

If other than a sole proprietor, please provide the following:

a) Date of Formation: mm/dd/yyyy

b) State/Country of Formation: {pick list}

6. Physical Street Address of the NMS Stock ATS matching system:

Street: \_\_\_\_\_

City \_\_\_\_\_ State \_\_ Zip Code \_\_\_\_\_

If the broker-dealer operator is a sole proprietor and the physical street address is a private residence, check this box:

A private residential address of a sole proprietor will not be included in publicly available versions of this form.

7. Mailing Address:  Same as physical address

Street: \_\_\_\_\_

City \_\_\_\_\_ State \_\_ Zip Code \_\_\_\_\_

If the broker-dealer operator is a sole proprietor and the mailing address is a private residence, check this box:

A private residential address of a sole proprietor will not be included in publicly available versions of this form.

8. Website URL of the NMS Stock ATS \_\_\_\_\_

Exhibit 1	Provide a copy of any materials currently provided to subscribers or other persons related to the operations of the NMS Stock ATS or the disclosures on Form ATS-N (e.g., FIX protocol procedures, rules of engagement/manuals, frequently asked questions, marketing materials).
Exhibit 2A	<p>Provide a copy of the most recently filed or amended Schedule A of the broker-dealer operator's Form BD disclosing information related to direct owners and executive officers.</p> <p><input type="checkbox"/> In lieu of filing {entity} certifies that the information requested under this exhibit is available at the Internet website below and is accurate as of the date of this filing.</p> <p>URL:</p>
Exhibit 2B	<p>Provide a copy of the most recently filed or amended Schedule B of the broker-dealer operator's Form BD disclosing information related to indirect owners.</p> <p><input type="checkbox"/> In lieu of filing {entity} certifies that the information requested under this exhibit is available at the Internet website below and is accurate as of the date of this filing.</p> <p>URL:</p>

**Part III. Activities of the Broker-Dealer Operator and Affiliates**

- Respond to each question below. Attach responses to each Item of Part III as Exhibit 3 with the information required for each “yes” response. Label each Item appropriately and organize responses according to Item number. For any Item or subpart of an Item that is inapplicable, state as such.
- For Items requesting the identity of affiliates and business units of the broker-dealer operator, provide the name under which each affiliate or business unit conducts business (e.g., the formal name under which a proprietary trading desk of the broker-dealer operator conducts business) and the applicable CRD number and MPID(s) under which the affiliate or business unit conducts business.
- For filings made pursuant to Rule 304(a)(2)(i) (i.e., Form ATS-N Amendments), also attach as Exhibit 3A a redline document to indicate additions to or deletions from any amended Item. Items in which there is no change do not need to be included within the Exhibit 3A.

<p><b>Item 1:</b> <b>Non-ATS Trading Centers</b></p>	<p>Does the broker-dealer operator, or any of its affiliates, operate or control any non-ATS trading center(s) that is an OTC market maker or executes orders in NMS stocks internally by trading as principal or crossing orders as agent (“non-ATS trading centers”)?</p> <p>If Yes:</p> <ul style="list-style-type: none"> <li>a) Identify the non-ATS trading center(s); and</li> <li>b) Describe any interaction or coordination between the non-ATS trading center(s) identified in Item 1(a) and the NMS Stock ATS, including: <ul style="list-style-type: none"> <li>i. Circumstances under which subscriber orders or other trading interest (such as quotes, indications of interest (“IOI”), conditional orders or messages (hereinafter collectively referred to as “trading interest”)) sent to the NMS Stock ATS are displayed or otherwise made known to the non-ATS trading center(s) identified in Item 1(a) before entering the NMS Stock ATS;</li> <li>ii. Circumstances under which subscriber orders or other trading interest received by the broker-dealer operator or its affiliates may execute, in whole or in part, in the non-ATS trading center(s) identified in Item 1(a) before entering the NMS Stock ATS; and</li> <li>iii. Circumstances under which subscriber orders or other trading interest are removed from the</li> </ul> </li> </ul>	<p>Yes <input type="checkbox"/> No <input type="checkbox"/></p>
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	NMS Stock ATS and sent to the non-ATS trading center(s) identified in Item 1(a).	
<b>Item 2: Multiple NMS Stock ATS Operations</b>	<p>Does the broker-dealer operator, or any of its affiliates, operate one or more NMS Stock ATSs other than the NMS Stock ATS named on this Form ATS-N?</p> <p>If Yes:</p> <ul style="list-style-type: none"> <li>a) Identify the NMS Stock ATS(s) and provide the MPID(s); and</li> <li>b) Describe any interaction or coordination between each NMS Stock ATS(s) identified in Item 2(a) and the NMS Stock ATS named on this Form ATS-N including: <ul style="list-style-type: none"> <li>i. The circumstances under which subscriber orders or other trading interest received by the broker-dealer operator or its affiliates to be sent to the NMS Stock ATS named on this Form ATS-N may be sent to an NMS Stock ATS identified in Item 2(a);</li> <li>ii. The circumstances under which subscriber orders or other trading interest to be sent to the NMS Stock ATS named on this Form ATS-N are displayed or otherwise made known in an NMS Stock ATS identified in Item 2(a); and</li> <li>iii. The circumstances under which subscriber orders or other trading interest received by the NMS Stock ATS named on this Form ATS-N may be removed and sent to the NMS Stock ATS(s) identified in Item 2(a).</li> </ul> </li> </ul>	Yes <input type="checkbox"/> No <input type="checkbox"/>
<b>Item 3: Products or Services Offered to Subscribers</b>	<p>Does the broker-dealer operator, or any of its affiliates, offer subscribers any products or services used in connection with trading on the NMS Stock ATS (e.g., algorithmic trading products, market data feeds)?</p> <p>If Yes:</p> <ul style="list-style-type: none"> <li>a) Describe the products or services, and identify the types of subscribers (e.g., retail, institutional, professional) to which such services or products are offered; and</li> <li>b) If the terms and conditions of the services or products are not the same for all subscribers, describe any differences.</li> </ul>	Yes <input type="checkbox"/> No <input type="checkbox"/>

<p><b>Item 4:</b> <b>Arrangements with Unaffiliated Trading Centers</b></p>	<p>Does the broker-dealer operator, or any of its affiliates, have any formal or informal arrangement with an unaffiliated person(s), or affiliate(s) of such person(s), that operates a trading center regarding access to the NMS Stock ATS, including preferential routing arrangements?</p> <p>If Yes:</p> <ul style="list-style-type: none"> <li>a) Identify the person(s) and the trading center(s); and</li> <li>b) Describe the terms of the arrangement(s).</li> </ul>	<p>Yes <input type="checkbox"/> No <input type="checkbox"/></p>
<p><b>Item 5:</b> <b>Trading Activities on the NMS Stock ATS</b></p>	<p>Does the broker-dealer operator, or any of its affiliates, enter orders or other trading interest on the NMS Stock ATS?</p> <p>If Yes:</p> <ul style="list-style-type: none"> <li>a) Identify each affiliate and business unit of the broker-dealer operator that may enter orders or other trading interest on the NMS Stock ATS;</li> <li>b) Describe the circumstances and capacity (e.g., proprietary or agency) in which each affiliate and business unit identified in Item 5(a) enters orders or other trading interest on the NMS Stock ATS;</li> <li>c) Describe the manner in which by which each affiliate or business unit identified in Item 5(a) enters orders or other trading interest on the NMS Stock ATS (e.g., directly through a Financial Information Exchange ("FIX") connection to the NMS Stock ATS, or indirectly, by way of the broker-dealer operator's SOR (or similar functionality), algorithm, intermediate application, or sales desk); and</li> <li>d) Describe any means by which a subscriber can be excluded from interacting or trading with orders or other trading interest of the broker-dealer operator or its affiliates on the NMS Stock ATS.</li> </ul>	<p>Yes <input type="checkbox"/> No <input type="checkbox"/></p>
<p><b>Item 6:</b> <b>Smart Order Router ("SOR") (or Similar Functionality) or Algorithms</b></p>	<p>Does the broker-dealer operator, or any of its affiliates, use a SOR(s) (or similar functionality), an algorithm(s), or both to send or receive subscriber orders or other trading interest to or from the NMS Stock ATS?</p> <p>If Yes:</p> <ul style="list-style-type: none"> <li>a) Identify the SOR(s) (or similar functionality) or algorithm(s) and identify the person(s) that operates the SOR(s) (or similar functionality) and algorithm(s), if other than the broker-dealer operator;</li> <li>b) Describe the interaction or coordination between the</li> </ul>	<p>Yes <input type="checkbox"/> No <input type="checkbox"/></p>

	<p>SOR(s) (or similar functionality) or algorithm(s) identified in Item 6(a) and the NMS Stock ATS, including any information or messages about orders or other trading interest (e.g., IOIs) that the SOR(s) (or similar functionality) or algorithm(s) send or receive to or from the NMS Stock ATS and the circumstances under which such information may be shared with any person.</p>	
<p><b>Item 7: Shared Employees of the NMS Stock ATS</b></p>	<p>Does any employee of the broker-dealer operator that services the operations of the NMS Stock ATS also service any other business unit(s) or any affiliate(s) of the broker-dealer operator ("shared employee")?</p> <p>If Yes:</p> <ul style="list-style-type: none"> <li>a) Identify the business unit(s) and/or the affiliate(s) of the broker-dealer operator to which the shared employee(s) provides services and identify the position(s) or title(s) that the shared employee(s) holds in the business unit(s) and/or affiliate(s) of the broker-dealer operator; and</li> <li>b) Describe the roles and responsibilities of the shared employee(s) at the NMS Stock ATS and the business unit(s) and/or affiliate(s) of the broker-dealer operator.</li> </ul>	<p>Yes <input type="checkbox"/> No <input type="checkbox"/></p>
<p><b>Item 8: Service Providers to the NMS Stock ATS</b></p>	<p>Is any operation, service, or function of the NMS Stock ATS performed by any person(s) other than the broker-dealer operator of the NMS Stock ATS?</p> <p>If Yes:</p> <ul style="list-style-type: none"> <li>a) Identify the person(s) (in the case of a natural person, identify only the person's position or title) performing the operation, service, or function and note whether this service provider(s) is an affiliate of the broker-dealer, if applicable;</li> <li>b) Describe the operation, service, or function that the person(s) identified in Item 8(a) provides and describe the role and responsibilities of that person(s); and</li> <li>c) State whether or not the person(s) identified in Item 8(a), or any of its affiliates, may enter orders or other trading interest on the NMS Stock ATS, and, if so, describe the circumstances and means by which such orders or other trading interest are entered on the NMS Stock ATS.</li> </ul>	<p>Yes <input type="checkbox"/> No <input type="checkbox"/></p>

<p><b>Item 9:</b> <b>Differences in Availability of Services, Functionalities or Procedures</b></p>	<p>Is there any service, functionality, or procedure of the NMS Stock ATS that is available or applies to the broker-dealer operator or its affiliates, that is not available or does not apply to a subscriber(s) to the NMS Stock ATS?</p> <p>If Yes:</p> <ul style="list-style-type: none"> <li>a) Identify the service, functionality, or procedure; and</li> <li>b) Describe the service, functionality, or procedure that is available to the broker-dealer operator or its affiliates but is not available or does not apply to a subscriber(s) to the NMS Stock ATS.</li> </ul>	<p>Yes <input type="checkbox"/> No <input type="checkbox"/></p>
<p><b>Item 10:</b> <b>Confidential Treatment of Trading Information</b></p>	<p>Describe the written safeguards and written procedures to protect the confidential trading information of subscribers to the NMS Stock ATS.</p> <p>Including:</p> <ul style="list-style-type: none"> <li>a) Describe the means by which a subscriber can consent or withdraw consent to the disclosure of confidential trading information to any persons (including the broker-dealer operator and any of its affiliates);</li> <li>b) Identify the positions or titles of any persons that have access to confidential trading information; describe the confidential trading information to which the persons have access; and describe the circumstances under which the persons can access confidential trading information;</li> <li>c) Describe the written standards controlling employees of the NMS Stock ATS that trade for employees' accounts; and</li> <li>d) Describe the written oversight procedures to ensure that the safeguards and procedures described above are implemented and followed.</li> </ul>	

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**Part IV. The NMS Stock ATS Manner of Operations**

- Respond to the questions below. Attach responses to each Item to Part IV as Exhibit 4 with the information required for each disclosure. Label each Item appropriately and organize responses according to Item number. For any Item or subpart of an Item that is inapplicable, state as such.
- For filings made pursuant to Rule 304(a)(2)(i) (i.e., Form ATS-N Amendments), also attach as Exhibit 4A a redline document to indicate additions to or deletions from any Item which is being amended. Items in which there is no change do not need to be included within the Exhibit 4A

<p><b>Item 1:</b> <b>Subscribers</b></p>	<ul style="list-style-type: none"><li>a) <i>Eligibility:</i> Describe any eligibility requirements to gain access to the services of the NMS Stock ATS. If the eligibility requirements are not the same for all subscribers and persons, describe any differences.</li><li>b) <i>Terms and Conditions of Use:</i> Describe the terms and conditions of any contractual agreements for granting access to the NMS Stock ATS for the purpose of effecting transactions in securities or for submitting, disseminating, or displaying orders on the NMS Stock ATS. State whether these contractual agreements are written. If the terms or conditions of any contractual agreements are not the same for all subscribers and persons, describe any differences.</li><li>c) <i>Types of Subscribers:</i> Describe the types of subscribers and other persons that use the services of the NMS Stock ATS (e.g., institutional investors, retail investors, broker-dealers, proprietary trading firms). State whether the NMS Stock ATS accepts non-broker-dealers as subscribers to the ATS. Describe any criteria for distinguishing among types of subscribers, classes of subscribers, or other persons.</li><li>d) <i>Liquidity Providers:</i> Describe any formal or informal arrangement the NMS Stock ATS has with a subscriber(s) or person(s) to provide liquidity to the NMS Stock ATS (e.g., undertaking to buy or sell continuously, or to meet specified thresholds of trading or quoting activity). Describe the terms and conditions of each arrangement and identify any liquidity providers that are affiliates of the broker-dealer operator.</li><li>e) <i>Limitation and Denial of Services:</i> Describe the circumstances by which access to the NMS Stock ATS for a subscriber or other person may be limited or denied, and describe any procedures or standards that are used to determine such action. If the circumstances, procedures, or standards are not applicable to all subscribers and persons, describe any differences.</li></ul>
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<p><b>Item 2:</b> <b>Hours of Operations</b></p>	<p>a) <i>Hours</i>: Provide the days and hours of operation of the NMS Stock ATS, including the times when orders or other trading interest are entered on the NMS Stock ATS and the time when pre-opening or after-hours trading occur.</p> <p>b) <i>Application</i>: If the times when orders or other trading interest are entered on the NMS Stock ATS are not the same for all subscribers and persons, describe any differences.</p>
<p><b>Item 3:</b> <b>Types of Orders</b></p>	<p>a) <i>Order Types and Modifiers</i>: Describe any types of orders that are entered on the NMS Stock ATS, their characteristics, operations, and how they are handled on the NMS Stock ATS, including:</p> <ul style="list-style-type: none"> <li>i. priority for each order type, including the order type's priority upon order entry and any subsequent change to priority (if applicable); whether the order type can receive a new time stamp; the order type's priority vis-à-vis other orders on the book due to changes in the NBBO or other reference price; and any instance in which the order type could lose execution priority to a later arriving order at the same price;</li> <li>ii. conditions for each order type, including any price conditions, including how the order type is ranked and how price conditions affect the rank and price at which it can be executed; conditions on the display or non-display of an order; or conditions on executability and routability;</li> <li>iii. order types designed not to remove liquidity (e.g., post-only orders), including what occurs when such order is marketable against trading interest on the NMS Stock ATS when received;</li> <li>iv. order types that adjust their price as changes to the order book occur (e.g., price sliding orders or pegged orders) or have a discretionary range, including an order's rank and price upon order entry and whether such prices or rank may change based on the NBBO or other market conditions when using such order type; when the order type is executable and at what price the execution would occur; whether the price at which the order type can be executed ever changes; and if the order type can operate in different ways, the default operation of the order type;</li> <li>v. the time-in-force instructions that can be used or not used with each order type;</li> <li>vi. the availability of order types across all forms of connectivity to the NMS Stock ATS and differences, if any, between the availability of an order type across those forms of connectivity;</li> <li>vii. whether an order type is eligible for routing to other trading centers, including, if the order type is routable, whether it can be used with any routing services offered; and</li> <li>viii. the circumstances under which order types may be combined with a time-in-force or another order type, modified, replaced, canceled, rejected, or removed from the NMS Stock ATS.</li> </ul> <p>b) <i>Application</i>: If the availability of order types and their terms and conditions are not the same for all subscribers and persons, describe</p>

	<p>any differences.</p> <p>c) <i>Order Size Requirements and Odd-Lot Orders</i>: Describe any requirements and handling procedures for minimum order sizes, odd-lot orders, or mixed-lot orders. If the requirements and handling procedures for minimum order sizes or, odd lot orders, or mixed lot orders are not the same for all subscribers and persons, describe any differences.</p> <p>d) <i>Indications of Interest ("IOI") and Conditional Orders</i>: Describe any messages sent to or received by the NMS Stock ATS indicating trading interest (e.g., IOIs, actionable IOIs, or conditional orders), including the information contained in the message, the means under which messages are transmitted, the circumstances in which messages are transmitted (e.g., automatically by the NMS Stock ATS, or upon the subscriber's request), and the circumstances in which they may result in an execution on the NMS Stock ATS. If the terms and conditions regarding these messages, indications of interests, and conditional orders are not the same for all subscribers and persons, describe any differences.</p>
<p><b>Item 4:</b> <b>Connectivity, Order Entry, and Co-location</b></p>	<p>a) <i>Connectivity and Order Entry</i>: Describe the means by which subscribers or other persons connect to the NMS Stock ATS and enter orders or other trading interest on the NMS Stock ATS (e.g., directly, through a Financial Information eXchange ("FIX") connection to the ATS, or indirectly, through the broker-dealer operator's SOR, or any intermediate functionality, algorithm, or sales desk). If the terms and conditions for connecting and entering orders or other trading interest on the NMS Stock ATS are not the same for all subscribers and persons, describe any differences.</p> <p>b) <i>Co-Location</i>: Describe any co-location services or any other means by which any subscriber or other persons may enhance the speed by which to send or receive orders, trading interest, or messages to or from the NMS Stock ATS. Describe the terms and conditions of co-location services. If the terms and conditions of the co-location services are not the same for all subscribers and persons, describe any differences.</p>
<p><b>Item 5:</b> <b>Segmentation of Order Flow and Notice About Segmentation</b></p>	<p>a) <i>Categories</i>: Describe any segmentation of orders or other trading interest on the NMS Stock ATS (e.g., classification by type of participant, source, nature of trading activity) and describe the segmentation categories, the criteria used to segment these categories, and procedures for determining, evaluating, and changing segmented categories. If the segmented categories, the criteria used to segment these categories, and any procedures for determining, evaluating or changing segmented categories are not the same for all subscribers and persons, describe any differences.</p> <p>b) <i>Notice about Segmentation</i>: State whether the NMS Stock ATS</p>

	<p>notifies subscribers or persons about the segmentation category that a subscriber or a person is assigned. Describe any notice provided to subscribers or persons about the segmentation category that they are assigned and the segmentation identified in 5(a), including the content of any notice and the means by which any notice is communicated. If the notice is not the same for all subscribers and persons, describe any differences.</p> <p>c) <i>Order Preferencing</i>: Describe any means and the circumstances by which a subscriber, the broker-dealer operator, or any of its affiliates may designate an order or trading interest submitted to the NMS Stock ATS to interact or not to interact with specific orders, trading interest, or persons on the NMS Stock ATS (e.g., designating an order or trading interest to be executed against a specific subscriber) and how such designations affect order priority and interaction.</p>
<p><b>Item 6:</b> <b>Display of Order and Trading Interest</b></p>	<p>a) <i>Display</i>: Describe any means and circumstances by which orders or other trading interest on the NMS Stock ATS are displayed or made known outside the NMS Stock ATS and the information about the orders and trading interest that are displayed. If the display of orders or other trading interest is not the same for all subscribers and persons, describe any differences.</p> <p>b) <i>Recipients</i>: Identify the subscriber(s) or person(s) (in the case of a natural person, identify only the person's position or title) to whom the orders and trading interest are displayed or otherwise made known.</p>
<p><b>Item 7:</b> <b>Trading Services</b></p>	<p>a) <i>Matching Methodology</i>: Describe the means or facilities used by the NMS Stock ATS to bring together the orders of multiple buyers and sellers, including the structure of the market (e.g., crossing system, auction market, limit order matching book). If the use of these means or facilities are not the same for all subscribers and persons, describe any differences.</p> <p>b) <i>Order Interaction Rules</i>: Describe the established, non-discretionary methods that dictate the terms of trading among multiple buyers and sellers on the facilities of the NMS Stock ATS, including rules and procedures governing the priority, pricing methodologies, allocation, matching, and execution of orders and other trading interest. If the rules and procedures are not the same for all subscribers and persons, describe any differences.</p> <p>c) <i>Other Trading Procedures</i>: Describe any trading procedures related to price protection mechanisms, short sales, locked-crossed markets, the handling of execution errors, time-stamping of orders and executions, or price improvement functionality. If the trading procedures are not the same for all subscribers and persons, describe any differences.</p>
<p><b>Item 8:</b></p>	<p>a) <i>Suspension of Trading, System Disruption or Malfunction</i>: Describe any procedures governing trading in the event the NMS</p>

<b>Suspension of Trading, System Disruption or Malfunction</b>	<p>Stock ATS suspends trading or experiences a system disruption or system malfunction. If the procedures governing trading during a suspension or system disruption or malfunction are not the same for all subscribers and persons, describe any differences.</p>
<b>Item 9: Opening, Reopening, and Closing Processes, and After Hours Procedures</b>	<ul style="list-style-type: none"> <li>a) <i>Opening and Reopening Processes:</i> Describe any opening and reopening processes, including how orders or other trading interest are matched and executed prior to the start of regular trading hours or following a stoppage of trading in a security during regular trading hours and how unexecuted orders or other trading interest are handled at the time the NMS Stock ATS begins regular trading at the start of regular trading hours or following a stoppage of trading in a security during regular trading hours. Describe any differences between pre-opening executions, executions following a stoppage of trading in a security during regular trading hours, and executions during regular trading hours.</li> <li>b) <i>Closing Process:</i> Describe any closing process, including how unexecuted orders or other trading interest are handled at the close of regular trading. Describe any differences between the closing executions and executions during regular trading hours.</li> <li>c) <i>After-Hours Trading:</i> Describe any after-hours trading procedures, including how orders and trading interest are matched and executed during after-hours trading. Describe any differences between the after-hours executions and executions during regular trading hours.</li> </ul>
<b>Item 10: Outbound Routing</b>	<ul style="list-style-type: none"> <li>a) <i>Routing:</i> Describe the circumstances under which orders or other trading interest are routed from the NMS Stock ATS to another trading center, including whether outbound routing occurs at the affirmative instruction of the subscriber or at the discretion of the broker-dealer operator, and the means by which routing is performed (e.g., a third party or order management system or a SOR (or similar functionality) or algorithm of the broker-dealer operator or any of its affiliates).</li> <li>b) <i>Application:</i> If the means by which orders or other trading interest are routed from the NMS Stock ATS are not the same for all subscribers and persons, describe any differences.</li> </ul>
<b>Item 11: Market Data</b>	<ul style="list-style-type: none"> <li>a) <i>Market Data:</i> Describe the market data used by the NMS Stock ATS and the source of that market data (e.g., market data feeds disseminated by the consolidated data processor ("SIP") and market data feeds disseminated directly by an exchange or other trading center or third-party vendor of market data).</li> <li>b) <i>Usage:</i> Describe the specific purpose for which market data is used by the NMS Stock ATS, including how market data is used to determine the NBBO, protected quotes, pricing of orders and executions, and routing destinations.</li> </ul>

<p><b>Item 12:</b> <b>Fees</b></p>	<p>a) <i>Fees:</i> Describe any fees, rebates, or other charges of the NMS Stock ATS (e.g., connectivity fees, subscription fees, execution fees, volume discounts) and provide the range (e.g., high and low) of such fees, rebates, or other charges.</p> <p>b) <i>Application:</i> If the fees, rebates, or other charges of the NMS Stock ATS are not the same for all subscribers and persons, describe any differences.</p>
<p><b>Item 13:</b> <b>Trade Reporting, Clearance and Settlement</b></p>	<p>a) <i>Trade Reporting:</i> Describe any arrangements or procedures for reporting transactions on the NMS Stock ATS. If the trade reporting procedures are not the same for all subscribers and persons, describe any differences.</p> <p>b) <i>Clearance and Settlement:</i> Describe any arrangements or procedures undertaken by the NMS Stock ATS to facilitate the clearance and settlement of transactions on the NMS Stock ATS (e.g., whether the NMS Stock ATS becomes a counterparty, whether it submits trades to a registered clearing agency, or whether it requires subscribers to have arrangements with a clearing firm). If the clearance and settlement procedures are not the same for all subscribers and persons, describe any differences.</p>
<p><b>Item 14:</b> <b>Order Display and Execution Access</b></p>	<p>If the NMS Stock ATS displays orders in an NMS stock to any person other than employees of the NMS Stock ATS and executed 5% or more of the average daily trading volume in that NMS stock as reported by an effective transaction reporting plan for four of the preceding six calendar months:</p> <p>a) Provide the ticker symbol for each NMS stock displayed for each of the last 6 calendar months;</p> <p>b) Describe the manner in which the NMS Stock ATS displays such orders on a national securities exchange or through a national securities association; and</p> <p>c) Describe how the NMS Stock ATS provides access to such orders displayed in the national market system equivalent to the access to other orders displayed on that exchange or association.</p>
<p><b>Item 15:</b> <b>Fair Access</b></p>	<p>If the NMS Stock ATS executed 5% or more of the average daily trading volume in an NMS stock as reported by an effective transaction reporting plan for four of the preceding six calendar months:</p> <p>a) Provide the ticker symbol for each NMS stock for each of the last 6 calendar months; and</p> <p>b) Describe the written standards for granting access to trading on the NMS Stock ATS.</p>

<b>Item 16:</b> <b>Market Quality Statistics Published or Provided to Subscribers</b>	<p>If the NMS Stock ATS publishes or otherwise provides to one or more subscribers aggregate platform-wide order flow and execution statistics of the NMS Stock ATS that are not otherwise required disclosures under 17 CFR § 242.605:</p> <ul style="list-style-type: none"> <li>a) List and describe the categories or metrics of aggregate platform-wide order flow and execution statistics published or provided;</li> <li>b) Describe any criteria or methodology used to calculate aggregate platform-wide order flow and execution statistics; and</li> <li>c) Attach as Exhibit 5 the most recent disclosure of aggregate platform-wide order flow and execution statistics published or provided to one or more subscribers for each category or metric as of the end of the calendar quarter.</li> </ul>
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**Part V: Contact Information, Signature Block, and Consent to Service**

Provide the following information of the person at {the name of the NMS Stock ATS} prepared to respond to questions for this submission:

First Name: \_\_\_\_\_ Last Name: \_\_\_\_\_

Title: \_\_\_\_\_

E-Mail: \_\_\_\_\_ Telephone: \_\_\_\_\_

The {name of the NMS Stock ATS} consents that service of any civil action brought by, or notice of any proceeding before, the SEC or a self-regulatory organizations in connection with the alternative trading system's activities may be given by registered or certified mail or email to the contact employee at the primary street address or email address, or mailing address if different, given in Part I above. The undersigned, being first duly sworn, deposes and says that he/she has executed this form on behalf of, and with the authority of, said alternative trading system. The undersigned and {name of NMS Stock ATS} represents that the information and statements contained herein, including exhibits, schedules, or other documents attached hereto, and other information filed herewith, all of which are made a part hereof, are current, true, and complete.

Date {auto fill} \_\_\_\_\_ {Name of NMS Stock ATS}

By: \_\_\_\_\_ Title \_\_\_\_\_

(Digital sign)

## FORM ATS-N INSTRUCTIONS

### A. GENERAL INSTRUCTIONS:

- Form ATS-N is a public reporting form that is designed to provide the public and the Commission with information about the operations of the NMS Stock ATS and the activities of its broker-dealer operator and its affiliates. Form ATS-N is to be used by an NMS Stock ATS to qualify for the exemption from the definition of an “exchange” pursuant to Exchange Act Rule 3a1-1(a)(2), for which no other form is authorized or prescribed.
- An NMS Stock ATS must respond to each item, as applicable, in detail and disclose information that is accurate, current, and complete. An NMS Stock ATS must provide all the information required by the form, including the exhibits, and must present the information in a clear and comprehensible manner. A filing that is incomplete or similarly deficient may be returned to the NMS Stock ATS. Any filing so returned shall for all purposes be deemed not to have been filed with the Commission. See also Rule 0-3 under the Exchange Act (17 CFR 240.0-3).
- A separate Form ATS-N is required for each NMS Stock ATS operated by the same broker-dealer operator.

### B. WHEN TO FILE FORM ATS-N

- Form ATS-N: Prior to commencing operations, an NMS Stock ATS shall file a Form ATS-N and the Form ATS-N must be declared effective by the Commission. If the NMS Stock ATS is operating pursuant to a previously filed initial operation report on Form ATS as of the effective date of proposed Rule 304, such NMS Stock ATS shall file with the Commission a Form ATS-N no later than 120 calendar days after such effective date.
- Form ATS-N Amendment: An NMS Stock ATS shall amend an effective Form ATS-N: (1) at least 30 calendar days prior to the date of implementation of a material change to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that are subject to disclosure on Form ATS-N; (2) within 30 calendar days after the end of each calendar quarter to correct any other information that has become inaccurate for any reason and has not been previously reported to the Commission as a Form ATS-N Amendment; or (3) promptly, to correct information in any previous disclosure on Form ATS-N, after discovery that any information filed under paragraphs (a)(1)(i) or (a)(2)(i)(A) or (B) of proposed Rule 304 was inaccurate or incomplete when filed.
- Notice of Cessation: An NMS Stock ATS shall notice its cessation of operations on Form ATS-N at least 10 business days before the date the NMS Stock ATS will cease to operate as an NMS Stock ATS.

- **Withdrawal:** If an NMS Stock ATS determines to withdraw a Form ATS-N, it must select the appropriate check box and provide the correct file number to withdraw the submission.

### **C. HOW TO FILE A FORM ATS-N**

- Any report required to be submitted pursuant to Rule 304 of Regulation ATS shall be filed in an electronic format through the electronic form filing system ("EFFS"), a secure website operated by the Securities and Exchange Commission ("Commission"). Documents filed through the EFFS system must be in a text-searchable format without the use of optical character recognition.
- A duly authorized individual of the NMS Stock ATS shall electronically sign the completed Form ATS-N. In addition, a duly authorized individual of the NMS Stock ATS shall manually sign one copy of the completed Form ATS-N, and the manually signed signature page shall be preserved pursuant to the requirements of proposed Rule 303 of Regulation ATS.

### **D. CONTACT INFORMATION**

- The individual listed on the NMS Stock ATS's response to Part V of Form ATS-N as the contact representative must be authorized to receive all incoming communications and be responsible for disseminating that information, as necessary, within the NMS Stock ATS.

### **E. RECORDKEEPING**

- A copy of this Form ATS-N must be retained by the NMS Stock ATS and made available for inspection upon request of the SEC.

### **F. PAPERWORK REDUCTION ACT DISCLOSURE**

- Form ATS-N requires an NMS Stock ATS to provide the Commission with certain information regarding: (1) the operation of the NMS Stock ATS and the activities of the broker-dealer operator and its affiliates; (2) material and other changes to the operation of the NMS Stock ATS; and (3) notice upon ceasing operation of the alternative trading system. Form ATS-N is intended to provide the public with information about the operations of the NMS Stock ATS and the activities of the broker-dealer operator and its affiliates so that they may make an informed decision as to whether to participate on the NMS Stock ATS. In addition, the Form ATS-N is intended to provide the Commission with information to permit it to carry out its market oversight and investor protection functions.
- The information provided on Form ATS-N will help enable the Commission to determine whether an NMS Stock ATS is in compliance with the federal securities laws and the rules or regulations thereunder, including Regulation ATS. An NMS Stock ATS must:

(1) file Form ATS-N prior to commencing operations; (2) file a Form ATS-N Amendment at least 30 calendar days prior to the date of implementation of a material change to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that are subject to disclosure on Form ATS-N; (3) file a Form ATS-N Amendment within 30 calendar days after the end of each calendar quarter to correct any other information that has become inaccurate for any reason and has not been previously reported to the Commission on Form ATS-N; (4) file a Form ATS-N Amendment promptly to correct information in any previous disclosure on a Form ATS-N or a Form ATS-N Amendment after discovery that any information filed was inaccurate or incomplete when filed; and (5) notice its cessation of operations at least 10 business days before the date the NMS Stock ATS ceases to operate as an NMS Stock ATS.

- This collection of information will be reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. 3507. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Commission estimates that that an NMS Stock ATS will spend approximately 141.3 hours completing the Form ATS-N, approximately 9.5 hours preparing each amendment to Form ATS-N, and approximately 2 hours preparing a notice of cessation on Form ATS-N. Any member of the public may direct to the Commission any comments concerning the accuracy of this burden estimate and any suggestions for reducing this burden.

#### G. EXPLANATION OF TERMS

The following terms are defined for purposes of Form ATS-N.

- **AFFILIATE:** Shall mean, with respect to a specified person, any person that, directly or indirectly, controls, is under common control with, or is controlled by, the specified person.
- **ALTERNATIVE TRADING SYSTEM:** Shall mean any organization, association, person, group of persons, or system: (1) that constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of Rule 3b-16 under the Exchange Act; and (2) that does not (i) set rules governing the conduct of subscribers other than the conduct of such subscribers' trading on such organization, association, person, group of persons, or system, or (ii) discipline subscribers other than by exclusion from trading. 17 CFR 242.300(a).
- **BROKER-DEALER OPERATOR:** Shall mean the registered broker-dealer of the NMS Stock ATS pursuant to 17 CFR 242.301(b)(1).

- **CONTROL:** Shall mean the power, directly or indirectly, to direct the management or policies of the broker-dealer of an alternative trading system, whether through ownership of securities, by contract, or otherwise. A person is presumed to control the broker-dealer of an alternative trading system if that person: (1) is a director, general partner, or officer exercising executive responsibility (or having similar status or performing similar functions); (2) directly or indirectly has the right to vote 25 percent or more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities of the broker-dealer of the alternative trading system; or (3) in the case of a partnership, has contributed, or has the right to receive upon dissolution, 25 percent or more of the capital of the broker-dealer of the alternative trading system.
- **NMS SECURITY:** Shall mean any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options. 17 CFR 242.600(b)(46).
- **NMS STOCK:** Shall mean any NMS security other than an option. 17 CFR 242.600(b)(47).
- **NMS STOCK ATS:** Shall mean an alternative trading system, as defined in Rule 300(a) under the Exchange Act, that facilitates transactions in NMS stocks, as defined in Rule 300(g) under the Exchange Act. [Proposed] 17 CFR 242.300(k).
- **ORDER:** Shall mean any firm indication of a willingness to buy or sell a security as either principal or agent, including any bid or offer quotation, market order, limit order or other priced order. 17 CFR 242.300(e).
- **PERSON:** Shall mean a natural person or a company. 15 U.S.C. 80a-2(a)(28).
- **SUBSCRIBER:** Shall mean any person that has entered into a contractual agreement with an alternative trading system to access an alternative trading system for the purpose of effecting transactions in securities, or for submitting, disseminating or displaying orders on such alternative trading system, including a customer, member, user, or participant in an alternative trading system. A subscriber, however, shall not include a national securities exchange or association. 17 CFR 242.300(b).

By the Commission



Brent J. Fields  
Secretary

Dated: November 18, 2015

*Commissioner Prower  
Dissented as to paragraph  
28.c.*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 4273/ November 19, 2015

ADMINISTRATIVE PROCEEDING  
File No. 3-16223

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<b>In the Matter of</b>	:	<b>ORDER MAKING FINDINGS AND IMPOSING PENALTIES, REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AGAINST SANDS BROTHERS ASSET MANAGEMENT, LLC, STEVEN SANDS AND MARTIN SANDS</b>
<b>SANDS BROTHERS ASSET MANAGEMENT, LLC, STEVEN SANDS, MARTIN SANDS, AND CHRISTOPHER KELLY,</b>	:	
<b>Respondents.</b>	:	

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I.

The Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings on October 29, 2014, pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), against Sands Brothers Asset Management, LLC ("SBAM"), Steven Sands ("S. Sands"), Martin Sands ("M. Sands," and together with SBAM and S. Sands, the "Respondents") and Christopher Kelly ("Kelly").

On August 31, 2015, the Hearing Officer issued an Order on Motions for Summary Disposition pursuant to Rule of Practice 250(b), 17 C.F.R. § 201.250(b) (the "Order on Summary Disposition"), partially granting the motion of the Division of Enforcement ("Division") for summary disposition against Respondents. The Order on Summary Disposition denied the Division's motion for summary disposition as to sanctions and ordered additional proceedings to determine what civil penalties and remedial sanctions pursuant to Sections 203(e), 203(f), 203(i) and 203(k) of the Advisers Act against Respondents are in the public interest.

II.

In anticipation of those proceedings, Respondents have submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the

Commission's jurisdiction over them, the subject matter of these proceedings, and the findings contained in Sections III. 10, 11 and 12 below, which are admitted, Respondents consent to the entry of this Order Making Findings and Imposing Penalties, Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that

#### Summary

1. For the fiscal years 2010, 2011 and 2012, SBAM failed to timely distribute audited financial statements to the investors of the pooled investment vehicles managed by SBAM in violation of the "custody rule" – Rule 206(4)-2 under Section 206(4) of the Advisers Act – and without regard to an Order issued by the Commission in October 2010 requiring SBAM, S. Sands and M. Sands to cease and desist from violating or causing any future violations of that rule.

2. S. Sands and M. Sands, the two co-chairmen of SBAM, aided, abetted and caused SBAM's custody rule violations, and were not in compliance with the Commission's 2010 Cease-And-Desist Order when they failed to implement any procedures or safeguards to ensure compliance. In fact, none of the Respondents made adequate efforts to ensure that SBAM met its custody rule obligations, either by disseminating the audited financial statements that investors in certain of SBAM's-managed funds were entitled to receive, or alternatively by submitting to a surprise examination to verify client assets.

#### Respondents

3. SBAM is a New York limited liability company formed in June 1998, and has been registered with the Commission as an investment adviser since July of that year. SBAM maintains offices in New York, Connecticut and California, and provides investment advisory services to various pooled investment vehicles. As of July 2014, SBAM had approximately \$64 million under management. SBAM is owned by the Julios and Targhee Trusts, which are set up for the benefit of the families of M. Sands and S. Sands, SBAM's principals.

4. S. Sands, age 56, resides in Locust Valley, New York. He is a principal, co-founder, and controlling person of SBAM, and acts as a senior portfolio manager. He is also a controlling person or director of the managing members / general partners for the pooled investment vehicles that SBAM advises. S. Sands held Series 7, 24 and 63 licenses while previously employed at a number of broker dealers.

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<sup>1</sup> The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

5. M. Sands, age 54, resides in Greenwich, Connecticut. He is a principal, co-founder, and controlling person of SBAM, and acts as a senior portfolio manager. He is also a controlling person or director of the managing members / general partners for the pooled investment vehicles that SBAM advises. M. Sands held Series 3, 7, 8, 24, 63 and 65 licenses while previously employed at a number of broker dealers.

### The Custody Rule

6. Rule 206(4)-2, promulgated under Section 206(4) of the Advisers Act (the "custody rule"), is designed to protect investor assets. The custody rule requires that advisers who have custody of client assets put in place a set of procedural safeguards to prevent loss, misuse or misappropriation of those assets.

7. An adviser has "custody" of client assets if it holds, directly or indirectly, client funds or securities, or if it has the ability to obtain possession of those assets. 17 C.F.R. § 275.206(4)-2(d)(2).

8. An adviser who has custody must, among other things: (i) ensure that a qualified custodian maintains the client assets; (ii) have a reasonable basis for believing that the qualified custodian sends quarterly account statements to clients; and (iii) ensure that client funds and securities are verified by actual examination each year by an independent public accountant. *Id.* § 275.206(4)-2(a)(1), (3), (4).

9. The custody rule provides an alternative for advisers to pooled investment vehicles. In relevant part, the rule prescribes that an adviser "shall be deemed to have complied with" the independent verification requirement if the adviser "distributes its audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) within 120 days of the end of its fiscal year." *Id.* § 275.206(4)-2(b)(4)(i). The accountant performing the audit must be an independent public accountant that is registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board. *Id.* § 275.206(4)-2(b)(4)(ii). An adviser that takes this approach is also not required to satisfy the account statements delivery requirement described above. *Id.* § 275.206(4)-2(b)(4).

### The Order on Summary Disposition

10. In the Order on Summary Disposition, the Hearing Officer determined that SBAM willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder by failing to distribute to investors the fiscal year 2010, 2011 and 2012 audited financial statements of ten funds as to which SBAM acted as Investment Adviser within the period provided for in Rule 206(4)-2.

11. The Hearing Officer further determined that M. Sands caused and willfully aided and abetted SBAM's violations as to the late distribution of five of the funds' fiscal year 2010 audited financial statements.

12. The Hearing Officer further determined that S. Sands and M. Sands caused and willfully aided and abetted SBAM's violations as to the late distribution of ten of the funds' fiscal year 2011 and 2012 audited financial statements.

### **SBAM's History of Non-Compliance with the Custody Rule**

13. SBAM provides investment advisory services to a number of pooled investment vehicles. At all times relevant hereto, SBAM served as investment adviser to the following pooled investment vehicles: Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital II LLC, Sands Brothers Venture Capital III LLC, Sands Brothers Venture Capital IV LLC, Katie & Adam Bridge Partners LP, Granite Associates, LLC, 280 Ventures LLC, Genesis Merchant Partners LP, Genesis Merchant Partners II LP, Vantage Point Partners LP, Select Access LLC, Select Access (Institutional) LLC, Select Access III LLC, and SB Opportunity Technology Associates Institution LLC.

14. In 1999, the staff of the Commission's Office of Compliance Inspection and Examinations ("OCIE") performed an examination of SBAM. As a result of that examination, a deficiency letter was issued that concluded, among other things, that SBAM wrongly stated in its Form ADV that it does not have custody of client assets. To the contrary, by virtue of the relationship of the Adviser to its pooled investment vehicles, and the relationship between S. Sands and M. Sands and the managing members / general partners of those vehicles, SBAM did in fact appear to have custody of client assets.<sup>2</sup>

15. The deficiency letter, addressed to M. Sands, went on to spell out some of the requirements that SBAM had to meet as a custodian of investor assets.

16. In 2010, as a result of subsequent OCIE examinations in 2004 and 2009 and an investigation by the Division of Enforcement, SBAM, M. Sands and S. Sands consented, without admitting or denying the findings therein, to the entry of an Order Instituting Administrative and

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<sup>2</sup> All but one of the funds at issue in the 1999 deficiency letter were different from the funds that SBAM advises today. Nonetheless, the arrangements cited in 1999 leading the staff to conclude that SBAM had custody over client assets exist with respect to SBAM's current funds. As to the one fund that SBAM still advises that was addressed in the 1999 deficiency letter – Katie and Adam Bridge Partners, L.P. – the exam staff concluded that SBAM appeared to have custody of investor assets because a provision in the Limited Partnership Agreement provided that the General Partner, controlled by S. Sands and M. Sands, had authority to "open, maintain, and close bank accounts and draw checks or other orders for the payment of monies...." That arrangement remained the same.

Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 (the “2010 Order”).

17. Among other findings, the Commission’s 2010 Order found that SBAM willfully violated the custody rule by improperly relying on the pooled investment vehicle alternative, which allowed for the distribution of audited financial statements in lieu of submitting to a surprise examination by an independent public accountant to verify custody of assets, among other requirements. In particular, SBAM: (i) failed to submit to an adequate audit performed in accordance with generally accepted standards; and (ii) did not timely distribute audited financial statements. The Commission’s 2010 Order further found that SBAM continued to state in its Forms ADV that it did not have custody over client funds when, in fact, it did.<sup>3</sup> (2010 Order ¶¶ 7-11.)

18. The Commission’s 2010 Order concluded that, as the lead principals primarily responsible for the relevant SBAM actions, S. Sands and M. Sands willfully aided and abetted and caused SBAM’s violations of the custody rule. (*Id.* ¶¶ 4, 13(e).)

19. In light of these and other violations of the Advisers Act, the Commission’s 2010 Order ordered that: (i) SBAM, S. Sands and M. Sands cease and desist from committing or causing violations or future violations of, among other things, the custody rule; (ii) SBAM, S. Sands and M. Sands be censured; and (iii) SBAM pay a civil money penalty of \$60,000. (*Id.* § IV(A)-(C).)

#### **SBAM Continued to Violate the Custody Rule After the 2010 Order**

20. The 2010 Order notwithstanding, SBAM failed to comply with the custody rule in the years that followed. SBAM neither submitted to a surprise examination, nor distributed its audited financials in the 120-day window imposed by the rule. Indeed, SBAM took no remedial action in response to the 2010 Order to implement policies or procedures aimed at ensuring compliance with the custody rule.

21. For the period 2010 through 2012, SBAM had custody of client assets within the meaning of Rule 206(4)-2(d)(2). At no time from 2010 through the present has SBAM submitted to a surprise examination by an independent public accountant.

22. SBAM distributed its funds’ audited financial statements for the fiscal years 2010 – 2012 after the 120-day custody rule deadline.

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<sup>3</sup> In addition to the custody rule deficiencies, the 2010 Order found violations of Advisers Act Section 204 and Rule 204-2 for failing to make, keep and furnish copies of certain books and records to the Commission, and Sections 204 and 207 and Rule 204-1 for making inaccurate statements in, and failing to properly file, its Form ADV.

a. Audited financial statements for the fiscal year 2010 were distributed at least 40 days late for the following funds: Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital II LLC, Sands Brothers Venture Capital III LLC, Sands Brothers Venture Capital IV LLC, Katie & Adam Bridge Partners LP, Granite Associates, LLC, 280 Ventures LLC, Genesis Merchant Partners LP, Genesis Merchant Partners II LP and Vantage Point Partners LP (collectively, the "Ten Funds");

b. Audited financial statements for the fiscal year 2011 were distributed at least 191 days (over 6 months) late and up to 242 days (nearly 8 months) late for the Ten Funds; and

c. Audited financial statements for the fiscal year 2012 were distributed at least 84 days and up to 93 days (approximately 3 months) late for the Ten Funds.

23. The circumstances that led the audits to be delayed were predictable and not unforeseeable. As SBAM's auditors noted with respect to the audit for the fiscal year 2012, "[t]here was a delay in the timely receipt from [SBAM] management of the information supporting the valuation of non-performing loans . . . which significantly affected the completion of the audit and the timely issuance of the financial statements." The conditions underlying that delay "were known or identifiable before the commencement of the audits," and therefore "a more proactive timely approach by your valuation staff in identifying these situations and obtaining the necessary documentation . . . could alleviate most of the audit issues." Indeed, the auditors had repeated difficulty obtaining the information they needed to value the same portfolio companies year over year. This was so even though for some of those companies, S. Sands and/or M. Sands served on the company's board, and for one such portfolio company, Kelly acted as President and Chief Executive Officer.

24. S. Sands and M. Sands knew or were reckless in not knowing about, and substantially assisted, SBAM's violations of the custody rule. In the wake of the 2010 Order – which specifically found that S. Sands and M. Sands aided, abetted and caused SBAM's custody rule violations – S. Sands and M. Sands were aware of the custody rule requirements; indeed, S. Sands and M. Sands executed a notarized offer of settlement to enter into the 2010 Order. And, they knew about SBAM's failure to timely distribute audited financial statements because they regularly communicated with the auditors during the audit process and signed representation letters immediately prior to the completion of each year's audit. Further, as the principals and founders of SBAM, S. Sands and M. Sands were responsible for ensuring that SBAM's compliance personnel has the authority to implement whatever procedures and policies are necessary to ensure that SBAM complied with the Advisers Act. Additionally, as subjects of the 2010 Order, they were responsible for ensuring that SBAM did not engage in future violations of the custody rule.

### Violations

25. As a result of the conduct described above, SBAM willfully violated Section 206(4) of the Advisers Act, which prohibits a registered investment adviser from engaging in fraudulent, deceptive or manipulative conduct, and Rule 206(4)-2 thereunder, which requires an adviser to take certain enumerated steps to safeguard client assets over which it has custody.

26. As a result of the conduct described above, S. Sands and M. Sands willfully aided and abetted and caused SBAM's violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder.

### Undertakings

Respondents have undertaken to:

27. Independent Monitor.

a. Within thirty (30) days of the date of this Order, S. Sands and M. Sands shall cause SBAM to engage an Independent Monitor which is not unacceptable to the Commission staff (the "Monitor"), for a period running from the date of the Monitor's retention through November 30, 2018, to oversee Respondents' compliance with all applicable securities laws, rules and regulations, including but not limited to the Advisers Act and the Undertakings in this Order. The Monitor's compensation and expenses shall be borne exclusively by Respondents and without direct or indirect reimbursement from any of the funds for which SBAM acts as investment adviser (the "Funds").

b. Respondents shall require that the Monitor perform annual reviews of SBAM ("Reviews"), within 60 (sixty) days of the last day of each applicable year, for its compliance with applicable securities laws, rules and regulations, with the first review as of December 31, 2015, the second review as of December 31, 2016, and the final review, as of December 31, 2017.

c. Respondents shall provide to the Commission staff, within thirty (30) days of retaining the Monitor, a copy of the engagement letter detailing the Monitor's responsibilities, which shall include the Reviews to be made by the Monitor as described in this Order.

d. Respondents shall require that, within forty-five (45) days from the end of each annual review, the Monitor shall submit a written and dated report of its findings to SBAM and to the Commission staff (the "Report"). Respondents shall require that each Report include a description of the review performed, the names of the individuals who performed the review, the conclusions reached, the Monitor's recommendations for changes in or improvements to SBAM's policies and procedures and/or practices, and a procedure for implementing the recommended changes in or improvements to SBAM's policies and procedures and/or practices.

e. Respondents shall adopt all recommendations contained in the Report within sixty (60) days of the date of the receipt of the Report, provided, however, that within forty-five (45) days after the date of the applicable Report, Respondents shall in writing advise the Monitor and the Commission staff of any recommendations that SBAM considers to be unduly burdensome, impractical, or inappropriate. With respect to any recommendation that Respondents consider unduly burdensome, impractical or inappropriate, SBAM need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure or system designed to achieve the same objective or purpose as that recommended by the Monitor. As to any recommendation with respect to SBAM policies and procedures and/or practices on which Respondents and the Monitor do not agree, Respondents and the Monitor shall attempt in good faith to reach an agreement within sixty (60) days after the date of the applicable Report. Within seventy-five (75) days after the date of the applicable Report, Respondents shall require that the Monitor inform Respondents and the Commission staff in writing of the Monitor's final determination concerning any recommendation that Respondents consider to be unduly burdensome, impractical or inappropriate. Respondents shall abide by the determinations of the Monitor and within sixty (60) days after final agreement between Respondents and the Monitor or final determination by the Monitor, whichever occurs first, Respondents shall adopt and implement all of the recommendations that the Monitor deems appropriate.

f. Within ninety (90) days of Respondents' adoption of all of the recommendations in a Report that the Monitor deems appropriate, as determined pursuant to the procedures set forth herein, M. Sands and S. Sands shall certify in writing to the Monitor and the Commission staff that Respondents have adopted and implemented all of the Monitor's recommendations in the applicable Report. Unless otherwise directed by the Commission staff, all Reports, certifications, and other documents required to be provided to the Commission staff shall be sent to Wendy Tepperman, Assistant Regional Director, Securities and Exchange Commission, 200 Vesey Street, New York, New York 10281, or such other address as the Commission staff may provide.

g. Respondents shall cooperate fully with the Monitor and shall provide the Monitor with access to such of SBAM's files, books, records, and personnel as are reasonably requested by the Monitor for review, including, if requested by the Monitor, access by on-site inspection.

h. To ensure the independence of the Monitor, Respondents: (1) shall not have the authority to terminate the Monitor or substitute another independent monitor for the initial Monitor, without the prior written approval of the Commission staff; and (2) shall compensate the Monitor and persons engaged to assist the Monitor for services rendered pursuant to this Order at their reasonable and customary rates.

i. Respondents shall require the Monitor to enter into an agreement that provides that for the period of engagement and for two (2) years after the completion of the period of engagement pursuant to this Order has ended, the Monitor shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with SBAM, or any of its current or former affiliates (including any of its managed funds), directors, officers, employees, or agents acting in their capacity as such.

j. Respondents shall not be in, and shall not have an attorney-client relationship with the Monitor and shall not seek to invoke the attorney-client privilege or any other doctrine or privilege to prevent the Monitor from transmitting any information, reports, or documents to the staff of the Commission.

k. The Commission staff may extend any of the procedural dates relating to the undertakings in Paragraphs (27)(b) through (f) for good cause shown as determined in the sole discretion of the Commission staff.

28. Evidence of SBAM's Compliance with the Custody Rule by Delivering Audited Financial Statements or Submitting to a Surprise Examination.

a. Satisfactory evidence of delivery of audited financial statements to investors.

1. By no later than 5:30 p.m. Eastern Time on May 10, 2016, Respondents shall provide to the Monitor, with a copy to the Commission staff, satisfactory evidence of SBAM's delivery to each of the Ten Funds' investors, by no later than 120 days after the end of each Fund's 2015 fiscal year, of each of the Ten Funds' fiscal year 2015 audited financial statements, prepared in accordance with generally accepted accounting principles, and audited by a PCAOB-registered independent public accountant, which has rendered an unqualified opinion as to each of the Ten Funds' financial statements.

2. By no later than 5:30 p.m. Eastern Time on May 10, 2017, Respondents shall provide to the Monitor, with a copy to the Commission staff, satisfactory evidence of SBAM's delivery to each of the Ten Funds' investors, by no later than 120 days after the end of each of the Ten Funds' 2016 fiscal year, of each of the Ten Funds' fiscal year 2016 audited financial statements, prepared in accordance with generally accepted accounting principles, and audited by a PCAOB-registered independent public accountant, which has rendered an unqualified opinion as to each of the Ten Funds' financial statements.

3. By no later than 5:30 p.m. Eastern Time on May 10, 2018, Respondents shall provide to the Monitor, with a copy to the Commission staff, satisfactory evidence of SBAM's delivery to each of the Ten Funds' investors, by no later than 120 days after the end of each of the Ten Funds' 2017 fiscal year, of each of the Ten Funds' fiscal year 2017 audited financial statements, prepared in accordance with generally accepted accounting principles, and audited by a PCAOB-registered independent public accountant, which has rendered an unqualified opinion as to each of the Ten Funds' financial statements.<sup>4</sup>

b. Satisfactory evidence of completion of surprise examination.

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<sup>4</sup> Should any of the Ten Funds' fiscal year end change from December 31, then the date by which Respondents must provide satisfactory evidence of delivery pursuant to this Paragraph 28 shall be the 131st day after the last day of that fund's new fiscal year end.

1. For any year, and for any of the Ten Funds, that Respondents elect to comply with the custody rule by undergoing a surprise examination, during that calendar year, by a PCAOB-registered independent public accountant in compliance with Rule 206(4)-2(a)(4) of the Advisers Act, SBAM shall notify the Monitor within thirty (30) days of engaging an independent public accountant to perform such surprise examination, and provide the Monitor with the terms of such engagement.

2. If Respondents comply with the obligations of Paragraph 28(b)(1), they are relieved of their obligation to provide satisfactory evidence of SBAM's delivery of audited financial statements as set forth in Paragraph 28(a) as to each fiscal year and as to each of the Ten Funds for which a certificate on Form ADV-E (17 C.F.R. § 279.8) has been filed within 120 days of the time chosen by the accountant engaged in paragraph 28(b)(1) above for such surprise examination.

c. Failure to comply. Respondents agree to make a payment of \$15,000 per each fund for each day that either (i) Respondents fail to provide the Monitor with satisfactory evidence of SBAM's delivery of each of the Ten Funds' audited financial statements to each of the Ten Funds' investors by the dates set out in Paragraph 28(a), unless relieved of such obligation under Paragraph 28(b)(2); or (ii) SBAM fails to deliver each of the Ten Funds' audited financial statements to each of the Ten Funds' investors by 120 days of each of the Ten Funds' fiscal year end, unless relieved of such obligation under Paragraph 28(b)(2). Such additional payments are in lieu of the Commission seeking a civil monetary penalty for Respondents' violation of this Order pursuant to Section 209(e)(4) of the Advisers Act. If Respondents fail to comply with either obligation set out in Paragraph 28(a), unless relieved of such obligations under Paragraph 28(b)(2), Respondents agree to make the \$15,000 payment per day for each of the Ten Funds as to which they have failed to comply.

Payment shall be made to the Commission for transfer to the general fund of the United States Treasury in accordance with Section 21F(g)(3) of the Securities Exchange Act of 1934. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

- (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying SBAM, S. Sands, and M. Sands as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Senior Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, Brookfield Place, 200 Vesey Street, New York, NY 10281.

29. Provide to the Commission, within 30 days after the end of the twelve (12) month suspension period described below, an affidavit that they have complied fully with the sanctions described in Section IV below.

30. Certify, in writing, compliance with the undertaking(s) set forth in paragraphs 27 and 28(a) and (b) above. The certification shall identify the undertaking(s), provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondents agree to provide such evidence. The certification and supporting material shall be submitted to Sanjay Wadhwa, Senior Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, Brookfield Place, 200 Vesey Street, New York, NY 10281, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

#### IV.

In view of the foregoing, the Commission deems it appropriate to impose the penalties, remedial sanctions, and cease-and-desist order agreed to in Respondents' Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 203(k) of the Advisers Act, Respondents SBAM, M. Sands, and S. Sands shall cease and desist from committing or causing any violations and any future violations of Section 206(4) and Rule 206(4)-2 promulgated thereunder.

B. Pursuant to Sections 203(e) and 203(f) of the Advisers Act, Respondents SBAM, M. Sands, and S. Sands be, and hereby are, suspended from acting as an investment adviser to any new clients or raising any monies or assets on behalf of the Funds from any new or existing investors, for a period of twelve (12) months after the entry of this Order.

C. Pursuant to Section 203(i) of the Advisers Act, Respondents SBAM, M. Sands, and S. Sands on a joint and several basis shall, within 14 days of the entry of this Order, pay a civil money penalty in the total amount of \$1,000,000 to the Commission for transfer to the general fund of the United States Treasury in accordance with Section 21F(g)(3) of the Securities Exchange Act of 1934. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

- (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying SBAM, M. Sands, and S. Sands as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Senior Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, Brookfield Place, 200 Vesey Street, New York, NY 10281.

D. Pursuant to Section 203(k) of the Advisers Act, Respondents SBAM, M. Sands, and S. Sands shall comply with their undertakings contained in Section III, paragraphs 27 and 28(a) and (b), above.

V.

It is further Ordered that, for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, the findings in this Order are true and admitted by Respondents, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondents under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondents of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. § 523(a)(19).

By the Commission.

Brent J. Fields  
Secretary

*Will M. Peterson*  
By **Will M. Peterson**  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4274/ November 19, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16223**

<b>In the Matter of</b>	:	<b>ORDER MAKING FINDINGS</b>
	:	<b>AND IMPOSING REMEDIAL</b>
	:	<b>SANCTIONS AND A CEASE-</b>
<b>SANDS BROTHERS ASSET</b>	:	<b>AND-DESIST ORDER PURSUANT</b>
<b>MANAGEMENT, LLC, STEVEN</b>	:	<b>TO SECTIONS 203(f)</b>
<b>SANDS, MARTIN SANDS</b>	:	<b>AND 203(k) OF THE INVESTMENT</b>
<b>AND CHRISTOPHER KELLY,</b>	:	<b>ADVISERS ACT OF 1940 AS TO</b>
	:	<b>CHRISTOPHER KELLY</b>
<b>Respondents.</b>	:	
	:	
	:	
	:	

**I.**

On October 29, 2014, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), against Sands Brothers Asset Management, LLC ("SBAM"), Steven Sands ("S. Sands"), Martin Sands ("M. Sands") and Christopher Kelly ("Kelly" or "Respondent").

On August 31, 2015, the Hearing Officer issued an Order on Motions for Summary Disposition pursuant to Rule of Practice 250(b), 17 C.F.R. § 201.250(b) (the "Order on Summary Disposition"), partially granting the motion of the Division of Enforcement ("Division") for summary disposition against Respondent. The Order on Summary Disposition denied the Division's motion for summary disposition as to sanctions and ordered additional proceedings to determine what civil penalties and remedial sanctions pursuant to Sections 203(f), 203(i) and 203(k) of the Advisers Act against Respondent are in the public interest.

**II.**

In anticipation of those proceedings, Respondent has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the

Commission's jurisdiction over him, the subject matter of these proceedings, and the findings contained in Sections III.9 and 10, below, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing Penalties, Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that

#### Summary

1. For the fiscal years 2010, 2011 and 2012, SBAM failed to timely distribute audited financial statements to the investors of the pooled investment vehicles managed by SBAM in violation of the "custody rule" – Rule 206(4)-2 under Section 206(4) of the Advisers Act – and without regard to an Order issued by the Commission in October 2010 requiring SBAM, S. Sands and M. Sands to cease and desist from violating or causing any future violations of that rule.

2. Kelly, the Chief Compliance/Chief Operating Officer of SBAM, aided, abetted and caused SBAM's custody rule violations, and was not in compliance with the Commission's 2010 Cease-And-Desist Order when he failed to implement any procedures or safeguards to ensure compliance. Kelly made no adequate efforts to ensure that SBAM met its custody rule obligations, either by disseminating the audited financial statements that investors in certain of SBAM's-managed funds were entitled to receive, or alternatively by submitting to a surprise examination to verify client assets.

#### Respondent and SBAM

3. SBAM is a New York limited liability company formed in June 1998, and has been registered with the Commission as an investment adviser since July of that year. SBAM maintains offices in New York, Connecticut and California, and provides investment advisory services to various pooled investment vehicles. As of July 2014, SBAM had approximately \$64 million under management. SBAM is owned by the Julios and Targhee Trusts, which are set up for the benefit of the families of M. Sands and S. Sands, SBAM's principals.

4. Kelly, age 57, resides in Greenwich, Connecticut. From 2008 through at least May 2014, Kelly was the Chief Compliance Officer, Chief Operating Officer and a partner at SBAM. According to the reports prepared by an independent compliance consultant retained by SBAM as a result of disciplinary proceedings instituted by the Connecticut Department of

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Banking, Kelly was responsible for all of SBAM's operations other than those that involved investment decision-making. Kelly is a lawyer and is presently licensed to practice in New York and the District of Columbia. Kelly previously held a Series 7 license.

### The Custody Rule

5. Rule 206(4)-2, promulgated under Section 206(4) of the Advisers Act (the "custody rule"), is designed to protect investor assets. The custody rule requires that advisers who have custody of client assets put in place a set of procedural safeguards to prevent loss, misuse or misappropriation of those assets.

6. An adviser has "custody" of client assets if it holds, directly or indirectly, client funds or securities, or if it has the ability to obtain possession of those assets. 17 C.F.R. § 275.206(4)-2(d)(2).

7. An adviser who has custody must, among other things: (i) ensure that a qualified custodian maintains the client assets; (ii) have a reasonable basis for believing that the qualified custodian sends quarterly account statements to clients; and (iii) ensure that client funds and securities are verified by actual examination each year by an independent public accountant. *Id.* § 275.206(4)-2(a)(1), (3), (4).

8. The custody rule provides an alternative for advisers to pooled investment vehicles. In relevant part, the rule prescribes that an adviser "shall be deemed to have complied with" the independent verification requirement if the adviser "distributes its audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) within 120 days of the end of its fiscal year." *Id.* § 275.206(4)-2(b)(4)(i). The accountant performing the audit must be an independent public accountant that is registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board. *Id.* § 275.206(4)-2(b)(4)(ii). An adviser that takes this approach is also not required to satisfy the account statements delivery requirement described above. *Id.* § 275.206(4)-2(b)(4).

### The Order on Summary Disposition

9. In the Order on Summary Disposition, the Hearing Officer determined that SBAM willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder by failing to distribute to investors the fiscal year 2010, 2011 and 2012 audited financial statements of ten funds as to which SBAM acted as Investment Adviser within the period provided for in Rule 206(4)-2.

10. The Hearing Officer further determined that Respondent caused and willfully aided and abetted SBAM's violations as to the late distribution of the ten funds' fiscal year 2011 and 2012 audited financial statements.

### SBAM's History of Non-Compliance with the Custody Rule

11. SBAM provides investment advisory services to a number of pooled investment vehicles. At all times relevant hereto, SBAM served as investment adviser to the following pooled investment vehicles: Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital II LLC, Sands Brothers Venture Capital III LLC, Sands Brothers Venture Capital IV LLC, Katie & Adam Bridge Partners LP, Granite Associates, LLC, 280 Ventures LLC, Genesis Merchant Partners LP, Genesis Merchant Partners II LP, Vantage Point Partners LP, Select Access LLC, Select Access (Institutional) LLC, Select Access III LLC, and SB Opportunity Technology Associates Institution LLC.

12. In 1999, the staff of the Commission's Office of Compliance Inspection and Examinations ("OCIE") performed an examination of SBAM. As a result of that examination, a deficiency letter was issued that concluded, among other things, that SBAM wrongly stated in its Form ADV that it does not have custody of client assets. To the contrary, by virtue of the relationship of the Adviser to its pooled investment vehicles, and the relationship between S. Sands and M. Sands and the managing members / general partners of those vehicles, SBAM did in fact appear to have custody of client assets.<sup>2</sup>

13. The deficiency letter, addressed to M. Sands, went on to spell out some of the requirements that SBAM had to meet as a custodian of investor assets.

14. In 2010, as a result of subsequent OCIE examinations in 2004 and 2009 and an investigation by the Division of Enforcement, SBAM, M. Sands and S. Sands consented, without admitting or denying the findings therein, to the entry of an Order Instituting Settled Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), 203(f) and 203(k) of the Advisers Act (the "2010 Order").

15. Among other findings, the Commission's 2010 Order found that SBAM willfully violated the custody rule by improperly relying on the pooled investment vehicle alternative, which allowed for the distribution of audited financial statements in lieu of submitting to a surprise examination by an independent public accountant to verify custody of assets, among

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<sup>2</sup> All but one of the funds at issue in the 1999 deficiency letter were different from the funds that SBAM advises today. Nonetheless, the arrangements cited in 1999 leading the staff to conclude that SBAM had custody over client assets exist with respect to SBAM's current funds. As to the one fund that SBAM still advises that was addressed in the 1999 deficiency letter – Katie and Adam Bridge Partners, L.P. – the exam staff concluded that SBAM appeared to have custody of investor assets because a provision in the Limited Partnership Agreement provided that the General Partner, controlled by S. Sands and M. Sands, had authority to "open, maintain, and close bank accounts and draw checks or other orders for the payment of monies...." That arrangement remained the same.

other requirements. In particular, SBAM: (i) failed to submit to an adequate audit performed in accordance with generally accepted standards; and (ii) did not timely distribute audited financial statements. The Commission's 2010 Order further found that SBAM continued to state in its Forms ADV that it did not have custody over client funds when, in fact, it did.<sup>3</sup> (2010 Order ¶¶ 7-11.)

16. The Commission's 2010 Order concluded that, as the lead principals primarily responsible for the relevant SBAM actions, S. Sands and M. Sands willfully aided, abetted and caused SBAM's violations of the custody rule. (*Id.* ¶¶ 4, 13(e).)

17. In light of these and other violations of the Advisers Act, the Commission's 2010 Order ordered that: (i) SBAM, S. Sands and M. Sands cease and desist from committing or causing violations or future violations of, among other things, the custody rule; (ii) SBAM, S. Sands and M. Sands be censured; and (iii) SBAM pay a civil money penalty of \$60,000. (*Id.* § IV(A)-(C).)

#### **SBAM Continued to Violate the Custody Rule After the 2010 Order**

18. The 2010 Order notwithstanding, SBAM failed to comply with the custody rule in the years that followed. SBAM neither submitted to a surprise examination, nor distributed its audited financials in the 120-day window imposed by the rule. Indeed, SBAM took no remedial action in response to the 2010 Order to implement policies or procedures aimed at ensuring compliance with the custody rule.

19. For the period 2010 through 2012, SBAM had custody of client assets within the meaning of Rule 206(4)-2(d)(2). At no time from 2010 through the present has SBAM submitted to a surprise examination by an independent public accountant.

20. SBAM distributed its funds' audited financial statements for the fiscal years 2010 – 2012 after the 120-day custody rule deadline.

a. Audited financial statements for the fiscal year 2010 were distributed at least 40 days late for the following funds: Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital II LLC, Sands Brothers Venture Capital III LLC, Sands Brothers Venture Capital IV LLC, Katie & Adam Bridge Partners LP, Granite Associates, LLC, 280 Ventures LLC, Genesis Merchant Partners LP, Genesis Merchant Partners II LP and Vantage Point Partners LP (collectively, the "Ten Funds");

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<sup>3</sup> In addition to the custody rule deficiencies, the 2010 Order found violations of Advisers Act Section 204 and Rule 204-2 for failing to make, keep and furnish copies of certain books and records to the Commission, and Sections 204 and 207 and Rule 204-1 for making inaccurate statements in, and failing to properly file, its Form ADV.

b. Audited financial statements for the fiscal year 2011 were distributed at least 191 days (over 6 months) late and up to 242 days (nearly 8 months) late for the Ten Funds; and

c. Audited financial statements for the fiscal year 2012 were distributed at least 84 days and up to 93 days (approximately 3 months) late for the Ten Funds.

21. The circumstances that led the audits to be delayed were predictable and not unforeseeable. As SBAM's auditors noted with respect to the audit for the fiscal year 2012, "[t]here was a delay in the timely receipt from [SBAM] management of the information supporting the valuation of non-performing loans . . . which significantly affected the completion of the audit and the timely issuance of the financial statements." The conditions underlying that delay "were known or identifiable before the commencement of the audits," and therefore "a more proactive timely approach by your valuation staff in identifying these situations and obtaining the necessary documentation . . . could alleviate most of the audit issues." Indeed, the auditors had repeated difficulty obtaining the information they needed to value the same portfolio companies year over year. This was so even though for some of those companies, S. Sands and/or M. Sands served on the company's board, and for one such portfolio company, Kelly acted as President and Chief Executive Officer.

22. Kelly knew or was reckless in not knowing about, and substantially assisted, SBAM's violations of the custody rule. Kelly executed the notarized offer of settlement to enter into the 2010 Order on behalf of SBAM. Further, SBAM's compliance manual tasked Kelly with "ensur[ing] compliance with the restrictions and requirements of Rule 206(4)-2 adopted under the Advisers Act." Kelly engaged the auditors for full audits (but not surprise examinations); he also signed representation letters to, and was a principal contact for, the auditors. He knew that the audited financial statements were not being distributed on time. Despite his responsibility to do so, Kelly, who was responsible for compliance and for all of SBAM's non-investment operations, implemented no policies or procedures to ensure compliance with the custody rule – even after the 2010 Order and after SBAM continued to miss its custody rule deadline year after year. At most, he simply reminded people of the custody rule deadline without taking any more substantial action. Kelly did not make any attempt to notify the staff of the Commission of any difficulties the Adviser was encountering in meeting the custody rule deadlines.

### Violations

23. As a result of the conduct described above, SBAM willfully violated Section 206(4) of the Advisers Act, which prohibits a registered investment adviser from engaging in fraudulent, deceptive or manipulative conduct, and Rule 206(4)-2 thereunder, which requires an adviser to take certain enumerated steps to safeguard client assets over which it has custody.

24. As a result of the conduct described above, Kelly willfully aided and abetted and caused SBAM's violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder.

#### IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Kelly's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 203(k) of the Advisers Act, Respondent shall cease and desist from committing or causing any violations and any future violations of Section 206(4) and Rule 206(4)-2 promulgated thereunder.

B. Pursuant to Section 203(f) of the Advisers Act, Respondent be, and hereby is, suspended from serving or acting as a Chief Compliance Officer of any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for twelve (12) months following the entry of this Order.

C. Pursuant to Section 203(i) of the Advisers Act, Respondent shall, within 10 days of the entry of the Order, pay a civil money penalty in the amount of \$60,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Section 21F(g)(3) of the Securities Exchange Act of 1934. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

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Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Christopher Kelly as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Senior Associate Director, Division of Enforcement, Securities and Exchange

Commission, New York Regional Office, Brookfield Place, 200 Vesey Street, New York, NY 10281.

V.

It is further Ordered that, for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. § 523(a)(19).

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES AND EXCHANGE ACT OF 1934**  
**Release No. 76477/ November 19, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16966**

In the Matter of	:	
	:	<b>ORDER INSTITUTING PUBLIC</b>
<b>CHRISTOPHER R. KELLY, Esq.</b>	:	<b>ADMINISTRATIVE PROCEEDINGS</b>
	:	<b>PURSUANT TO RULE 102(e) OF THE</b>
<b>Respondent.</b>	:	<b>COMMISSION'S RULES OF</b>
	:	<b>PRACTICE, MAKING FINDINGS,</b>
	:	<b>AND IMPOSING REMEDIAL</b>
	:	<b>SANCTIONS</b>

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against Christopher Kelly ("Respondent" or "Kelly") pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice.<sup>1</sup>

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings, herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.9 and 10 below, which are admitted, Respondent consents to the entry of this Order Making Findings, and Imposing Remedial Sanctions Pursuant to Rule 102(e) of the Commission's Rules of Practice ("Order"), as set forth below.

<sup>1</sup>

Rule 102(e)(1)(iii) provides, in pertinent part, that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found..to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

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### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>2</sup> that:

#### Summary

1. For the fiscal years 2010, 2011 and 2012, SBAM failed to timely distribute audited financial statements to the investors of the pooled investment vehicles managed by SBAM in violation of the "custody rule" – Rule 206(4)-2 under Section 206(4) of the Advisers Act – and without regard to an Order issued by the Commission in October 2010 requiring SBAM, S. Sands and M. Sands to cease and desist from violating or causing any future violations of that rule.

2. Kelly, the Chief Compliance/Chief Operating Officer of SBAM, aided, abetted and caused SBAM's custody rule violations, and was not in compliance with the Commission's 2010 Cease-And-Desist Order when he failed to implement any procedures or safeguards to ensure compliance. Kelly made no adequate efforts to ensure that SBAM met its custody rule obligations, either by disseminating the audited financial statements that investors in certain of SBAM's-managed funds were entitled to receive, or alternatively by submitting to a surprise examination to verify client assets.

#### Respondent and SBAM

3. SBAM is a New York limited liability company formed in June 1998, and has been registered with the Commission as an investment adviser since July of that year. SBAM maintains offices in New York, Connecticut and California, and provides investment advisory services to various pooled investment vehicles. As of July 2014, SBAM had approximately \$64 million under management. SBAM is owned by the Julios and Targhee Trusts, which are set up for the benefit of the families of M. Sands and S. Sands, SBAM's principals.

4. Kelly, age 57, resides in Greenwich, Connecticut. From 2008 through at least May 2014, Kelly was the Chief Compliance Officer, Chief Operating Officer and a partner at SBAM. According to the reports prepared by an independent compliance consultant retained by SBAM as a result of disciplinary proceedings instituted by the Connecticut Department of Banking, Kelly was responsible for all of SBAM's operations other than those that involved investment decision-making. Kelly is a lawyer and is presently licensed to practice in New York and the District of Columbia. Kelly previously held a Series 7 license.

#### The Custody Rule

5. Rule 206(4)-2, promulgated under Section 206(4) of the Advisers Act (the "custody rule"), is designed to protect investor assets. The custody rule requires that advisers

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<sup>2</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

who have custody of client assets put in place a set of procedural safeguards to prevent loss, misuse or misappropriation of those assets.

6. An adviser has “custody” of client assets if it holds, directly or indirectly, client funds or securities, or if it has the ability to obtain possession of those assets. 17 C.F.R. § 275.206(4)-2(d)(2).

7. An adviser who has custody must, among other things: (i) ensure that a qualified custodian maintains the client assets; (ii) have a reasonable basis for believing that the qualified custodian sends quarterly account statements to clients; and (iii) ensure that client funds and securities are verified by actual examination each year by an independent public accountant. *Id.* § 275.206(4)-2(a)(1), (3), (4).

8. The custody rule provides an alternative for advisers to pooled investment vehicles. In relevant part, the rule prescribes that an adviser “shall be deemed to have complied with” the independent verification requirement if the adviser “distributes its audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) within 120 days of the end of its fiscal year.” *Id.* § 275.206(4)-2(b)(4)(i). The accountant performing the audit must be an independent public accountant that is registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board. *Id.* § 275.206(4)-2(b)(4)(ii). An adviser that takes this approach is also not required to satisfy the account statements delivery requirement described above. *Id.* § 275.206(4)-2(b)(4).

#### **The Order on Summary Disposition**

9. In the Order on Summary Disposition, the Hearing Officer determined that SBAM willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder by failing to distribute to investors the fiscal year 2010, 2011 and 2012 audited financial statements of ten funds as to which SBAM acted as Investment Adviser within the period provided for in Rule 206(4)-2.

10. The Hearing Officer further determined that Respondent caused and willfully aided and abetted SBAM’s violations as to the late distribution of the ten funds’ fiscal year 2011 and 2012 audited financial statements.

#### **SBAM’s History of Non-Compliance with the Custody Rule**

11. SBAM provides investment advisory services to a number of pooled investment vehicles. At all times relevant hereto, SBAM served as investment adviser to the following pooled investment vehicles: Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital II LLC, Sands Brothers Venture Capital III LLC, Sands Brothers Venture Capital IV LLC, Katie & Adam Bridge Partners LP, Granite Associates, LLC, 280 Ventures LLC, Genesis Merchant Partners LP, Genesis Merchant Partners II LP, Vantage Point Partners LP, Select

Access LLC, Select Access (Institutional) LLC, Select Access III LLC, and SB Opportunity Technology Associates Institution LLC.

12. In 1999, the staff of the Commission's Office of Compliance Inspection and Examinations ("OCIE") performed an examination of SBAM. As a result of that examination, a deficiency letter was issued that concluded, among other things, that SBAM wrongly stated in its Form ADV that it does not have custody of client assets. To the contrary, by virtue of the relationship of the Adviser to its pooled investment vehicles, and the relationship between S. Sands and M. Sands and the managing members / general partners of those vehicles, SBAM did in fact appear to have custody of client assets.<sup>3</sup>

13. The deficiency letter, addressed to M. Sands, went on to spell out some of the requirements that SBAM had to meet as a custodian of investor assets.

14. In 2010, as a result of subsequent OCIE examinations in 2004 and 2009 and an investigation by the Division of Enforcement, SBAM, M. Sands and S. Sands consented, without admitting or denying the findings therein, to the entry of an Order Instituting Settled Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), 203(f) and 203(k) of the Advisers Act (the "2010 Order").

15. Among other findings, the Commission's 2010 Order found that SBAM willfully violated the custody rule by improperly relying on the pooled investment vehicle alternative, which allowed for the distribution of audited financial statements in lieu of submitting to a surprise examination by an independent public accountant to verify custody of assets, among other requirements. In particular, SBAM: (i) failed to submit to an adequate audit performed in accordance with generally accepted standards; and (ii) did not timely distribute audited financial statements. The Commission's 2010 Order further found that SBAM continued to state in its Forms ADV that it did not have custody over client funds when, in fact, it did.<sup>4</sup> (2010 Order ¶¶ 7-11.)

16. The Commission's 2010 Order concluded that, as the lead principals primarily responsible for the relevant SBAM actions, S. Sands and M. Sands willfully aided, abetted and caused SBAM's violations of the custody rule. (*Id.* ¶¶ 4, 13(e).)

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<sup>3</sup> All but one of the funds at issue in the 1999 deficiency letter were different from the funds that SBAM advises today. Nonetheless, the arrangements cited in 1999 leading the staff to conclude that SBAM had custody over client assets exist with respect to SBAM's current funds. As to the one fund that SBAM still advises that was addressed in the 1999 deficiency letter – Katie and Adam Bridge Partners, L.P. – the exam staff concluded that SBAM appeared to have custody of investor assets because a provision in the Limited Partnership Agreement provided that the General Partner, controlled by S. Sands and M. Sands, had authority to "open, maintain, and close bank accounts and draw checks or other orders for the payment of monies...." That arrangement remained the same.

<sup>4</sup> In addition to the custody rule deficiencies, the 2010 Order found violations of Advisers Act Section 204 and Rule 204-2 for failing to make, keep and furnish copies of certain books and records to the Commission, and Sections 204 and 207 and Rule 204-1 for making inaccurate statements in, and failing to properly file, its Form ADV.

17. In light of these and other violations of the Advisers Act, the Commission's 2010 Order ordered that: (i) SBAM, S. Sands and M. Sands cease and desist from committing or causing violations or future violations of, among other things, the custody rule; (ii) SBAM, S. Sands and M. Sands be censured; and (iii) SBAM pay a civil money penalty of \$60,000. (*Id.* § IV(A)-(C).)

**SBAM Continued to Violate the Custody Rule After the 2010 Order**

18. The 2010 Order notwithstanding, SBAM failed to comply with the custody rule in the years that followed. SBAM neither submitted to a surprise examination, nor distributed its audited financials in the 120-day window imposed by the rule. Indeed, SBAM took no remedial action in response to the 2010 Order to implement policies or procedures aimed at ensuring compliance with the custody rule.

19. For the period 2010 through 2012, SBAM had custody of client assets within the meaning of Rule 206(4)-2(d)(2). At no time from 2010 through the present has SBAM submitted to a surprise examination by an independent public accountant.

20. SBAM distributed its funds' audited financial statements for the fiscal years 2010 – 2012 after the 120-day custody rule deadline.

a. Audited financial statements for the fiscal year 2010 were distributed at least 40 days late for the following funds: Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital II LLC, Sands Brothers Venture Capital III LLC, Sands Brothers Venture Capital IV LLC, Katie & Adam Bridge Partners LP, Granite Associates, LLC, 280 Ventures LLC, Genesis Merchant Partners LP, Genesis Merchant Partners II LP and Vantage Point Partners LP (collectively, the "Ten Funds");

b. Audited financial statements for the fiscal year 2011 were distributed at least 191 days (over 6 months) late and up to 242 days (nearly 8 months) late for the Ten Funds; and

c. Audited financial statements for the fiscal year 2012 were distributed at least 84 days and up to 93 days (approximately 3 months) late for the Ten Funds.

21. The circumstances that led the audits to be delayed were predictable and not unforeseeable. As SBAM's auditors noted with respect to the audit for the fiscal year 2012, "[t]here was a delay in the timely receipt from [SBAM] management of the information supporting the valuation of non-performing loans . . . which significantly affected the completion of the audit and the timely issuance of the financial statements." The conditions underlying that delay "were known or identifiable before the commencement of the audits," and therefore "a more proactive timely approach by your valuation staff in identifying these situations and obtaining the necessary documentation . . . could alleviate most of the audit issues." Indeed, the auditors had repeated difficulty obtaining the information they needed to value the same portfolio companies year over year. This was so even though for some of those companies, S. Sands and/or M. Sands served on the company's board, and for one such portfolio company, Kelly acted as President and Chief Executive Officer.

22. Kelly knew or was reckless in not knowing about, and substantially assisted, SBAM's violations of the custody rule. Kelly executed the notarized offer of settlement to enter into the 2010 Order on behalf of SBAM. Further, SBAM's compliance manual tasked Kelly with "ensur[ing] compliance with the restrictions and requirements of Rule 206(4)-2 adopted under the Advisers Act." Kelly engaged the auditors for full audits (but not surprise examinations); he also signed representation letters to, and was a principal contact for, the auditors. He knew that the audited financial statements were not being distributed on time. Despite his responsibility to do so, Kelly, who was responsible for compliance and for all of SBAM's non-investment operations, implemented no policies or procedures to ensure compliance with the custody rule – even after the 2010 Order and after SBAM continued to miss its custody rule deadline year after year. At most, he simply reminded people of the custody rule deadline without taking any more substantial action. Kelly did not make any attempt to notify the staff of the Commission of any difficulties the Adviser was encountering in meeting the custody rule deadlines.

#### Violations

23. As a result of the conduct described above, SBAM willfully violated Section 206(4) of the Advisers Act, which prohibits a registered investment adviser from engaging in fraudulent, deceptive or manipulative conduct, and Rule 206(4)-2 thereunder, which requires an adviser to take certain enumerated steps to safeguard client assets over which it has custody.

#### Findings

24. As a result of the conduct described above, Kelly willfully aided and abetted SBAM's violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder.

#### IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanction agreed to in Respondent Kelly's Offer.

Accordingly, it is hereby ORDERED pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, effective immediately, that:

A. Kelly is denied the privilege of appearing or practicing before the Commission as an attorney for twelve (12) months from the date of the Order.

B. After twelve (12) months from the date of the Order, Respondent may request that the Commission consider his application to resume appearing and practicing before the Commission as an attorney. The application should be sent to the attention of the Office of the General Counsel.

C. In support of such an application, Respondent must provide a certificate of good standing from each state bar where Respondent is a member.

D. In support of such an application, Respondent must also submit an affidavit truthfully stating, under penalty of perjury:

1. that Respondent has complied with the Order;
2. that Respondent:
  - a. is not currently suspended or disbarred as an attorney by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession; and
  - b. since the entry of the Order, has not been suspended as an attorney for an offense involving moral turpitude by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession, except for any suspension concerning the conduct that was the basis for the Order;
3. that Respondent, since the entry of the Order, has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice; and
4. that Respondent, since the entry of the Order:
  - a. has not been found by the Commission or a court of the United States to have committed a violation of the federal securities laws, except for any finding concerning the conduct that was the basis for the Order;
  - b. has not been charged by the Commission or the United States with a violation of the federal securities laws, except for any charge concerning the conduct that was the basis for the Order;
  - c. has not been found by a court of the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, to have committed an offense involving moral turpitude, except for any finding concerning the conduct that was the basis for the Order; and
  - d. has not been charged by the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, with having committed an offense

involving moral turpitude, except for any charge concerning the conduct that was the basis for the Order.

E. If Respondent provides the documentation required in Paragraphs C and D, and the Commission determines that he truthfully attested to each of the items required in his affidavit, he shall by Commission order be permitted to resume appearing and practicing before the Commission as an attorney.

F. If Respondent is not able to truthfully attest to the statements required in Subparagraphs D(2)(b) or D(4), Respondent shall provide an explanation as to the facts and circumstances pertaining to the matter and the Commission may hold a hearing to determine whether there is good cause to permit him to resume appearing and practicing before the Commission as an attorney.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
Assistant Secretary

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-76480; File No. S7-08-14)**

November 19, 2015

**ORDER GRANTING A CONDITIONAL EXEMPTION UNDER THE SECURITIES EXCHANGE ACT OF 1934 FROM THE CONFIRMATION REQUIREMENTS OF EXCHANGE ACT RULE 10b-10(a) FOR CERTAIN TRANSACTIONS IN MONEY MARKET FUNDS**

**I. Introduction**

On July 23, 2014, the Securities and Exchange Commission (“Commission”) published a notice requesting comment on a proposal to grant a conditional exemption to broker-dealers, subject to certain conditions, from the immediate confirmation requirements of Rule 10b-10 of the Securities Exchange Act of 1934 (“Exchange Act”) for transactions effected in shares of institutional prime money market funds.<sup>1</sup> Concurrent with the issuance of the Notice, the Commission adopted amendments to Rule 2a-7 of the Investment Company Act of 1940 (“Investment Company Act”)<sup>2</sup> that, among other things, require institutional prime money market funds<sup>3</sup> to sell and redeem fund shares based on the current market-based value of the securities held in their portfolios (*i.e.*, transact at a “floating” net asset value (“NAV”)).<sup>4</sup> The Commission received two comments in response to the Notice.<sup>5</sup> After careful consideration the

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<sup>1</sup> See Notice of Proposed Exemptive Order Granting Permanent Exemptions Under the Securities Exchange Act of 1934 from the Confirmation Requirements of Exchange Act Rule 10b-10 for Certain Money Market Funds, Exchange Act Release No. 72658 (July 23, 2014), 79 FR 44076 (July 29, 2014) (“Notice”).

<sup>2</sup> 17 CFR 270.2a-7.

<sup>3</sup> “Institutional prime money market funds” are money market funds operating in accordance with Investment Company Act Rule 2a-7(c)(1)(ii), which include funds that are often referred to as (i) “tax exempt” or (ii) “municipal” funds that do not qualify as a “retail money market fund” as defined in Rule 2a-7(a)(25).

<sup>4</sup> See Money Market Fund Reform; Amendments to Form PF, Securities Act Release No. 9616, Investment Advisers Act Release No. 3879, Investment Company Act Release No. 31166 (July 23, 2014), 79 FR 47736, at section III.B (Aug. 14, 2014) (“Money Market Fund Reform Adopting Release”).

<sup>5</sup> See Letters to Kevin M. O’Neill, Deputy Secretary, Commission, from J. Charles Cardona, President, The Dreyfus Corporation (Aug. 19, 2014) (“Dreyfus Letter”), <http://www.sec.gov/comments/s7-08-14/s70814-2.pdf>; and

customers historically have received information about their transactions in shares of money market funds, including institutional prime money market funds, on a monthly basis.

Given that share prices of institutional prime money market funds likely will fluctuate under the Commission's amendments to Investment Company Act Rule 2a-7,<sup>11</sup> absent an exemption, broker-dealers would not be able to continue to rely on the exception under Exchange Act Rule 10b-10(b) for transactions in money market funds operating in accordance with Rule 2a-7(c)(1)(ii).<sup>12</sup> Instead, broker-dealers would be required to provide immediate confirmations for such transactions in accordance with Rule 10b-10(a).

To address the potential burdens created by such a requirement, the Commission published the Notice proposing to exempt broker-dealers from the requirements of Exchange Act Rule 10b-10(a) when effecting transactions in money market funds operating in accordance with Investment Company Act Rule 2a-7(c)(1)(ii), for or with the account of a customer, where: (i) no sales load is deducted upon the purchase or redemption of shares in the money market fund, (ii) the broker-dealer complies with the provisions of Rule 10b-10(b)(2) and Rule 10b-10(b)(3) that are applicable to money market funds that attempt to maintain a stable NAV

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17 CFR 240.10b-10(b)(2). Exchange Act Rule 10b-10(b)(3) requires the customer to be provided with prior notification in writing disclosing the intention to send the written information referred to in Rule 10b-10(b)(1) in lieu of an immediate confirmation. 17 CFR 240.10b-10(b)(3).

<sup>11</sup> 17 CFR 270.2a-7.

<sup>12</sup> See generally Money Market Fund Reform; Amendments to Form PF, Securities Act Release No. 9408, Investment Advisers Act Release No. 3616, Investment Company Act Release No. 30551 (June 5, 2013), 78 FR 36834, 36934 (June 19, 2013); see also Exchange Act Rule 10b-10(b)(1), 17 CFR 240.10b-10(b)(1) (limiting alternative monthly reporting to money market funds that attempt to maintain a stable NAV).

As adopted, government and retail money market funds are exempt from the Investment Company Act Rule 2a-7(c)(1)(ii) floating NAV requirement, and therefore, will continue to maintain a stable NAV. See Money Market Fund Reform Adopting Release, *supra* note 4, at sections III.C.1 and III.C.2. Accordingly, for investor transactions in the exempt funds, broker-dealers would continue to qualify for the exception under Rule 10b-10 and be permitted to send monthly transaction reports.

First, the attributes of institutional prime money market funds mitigate the need for the protections intended by confirmation delivery under Rule 10b-10(a).<sup>16</sup> For example, institutional prime money market funds will continue to be subject to the “risk limiting” provisions of Rule 2a-7, including those provisions governing the credit quality, liquidity, diversification, and maturity of fund investments.<sup>17</sup> Under those “risk limiting” provisions, mutual funds that hold themselves out as money market funds – including institutional prime money market funds – may acquire only investments that are short-term, high-quality, dollar-denominated instruments.<sup>18</sup> As a result, while the prices of institutional prime money market funds likely will fluctuate, they are not likely to exhibit regular day-to-day fluctuations, primarily due to the high quality and short duration of these funds’ underlying portfolio securities.<sup>19</sup>

Second, customers that need daily pricing information may obtain it through means other than confirmation statements.<sup>20</sup> For example, under the fund disclosure requirements of Investment Company Act Rule 2a-7(h)(10)(iii), customers – including institutional investors – will be able to access an institutional prime money market fund’s daily mark-to-market NAV per share through the fund’s website.<sup>21</sup>

Third, absent an exemption, broker-dealers are likely to incur significant costs associated with providing immediate, rather than monthly, confirmations for transactions in shares of

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<sup>16</sup> See Notice, 79 FR at 44077.

<sup>17</sup> Investment Company Act Rule 2a-7(d), 17 CFR 270.2a-7(d) (risk-limiting conditions).

<sup>18</sup> *Id.*; see also Money Market Fund Reform Adopting Release, 79 FR at 47775.

<sup>19</sup> Money Market Fund Reform Adopting Release, 79 FR at 47779 n.491.

<sup>20</sup> *Id.*, at section III.E.9.c; see also Notice, 79 FR at 44078.

<sup>21</sup> 17 CFR 270.2a-7(h)(10)(iii).

## **V. Conclusion**

In light of the above, and in accordance with Exchange Act Section 36<sup>24</sup> and Rule 10b-10(f),<sup>25</sup> the Commission finds that conditionally exempting broker-dealers from the requirements of Exchange Act Rule 10b-10(a) for transactions in institutional prime money market funds is necessary and appropriate in the public interest, and consistent with the protection of investors.

THEREFORE, IT IS HEREBY ORDERED, pursuant to Section 36 of the Exchange Act and Exchange Act Rule 10b-10(f), that broker-dealers shall be exempt from the written notification requirements under Exchange Act Rule 10b-10(a) when effecting transactions in money market funds operating in accordance with Investment Company Act Rule 2a-7(c)(1)(ii), for or with the account of a customer, where: (i) no sales load is deducted upon the purchase or redemption of shares in the money market fund, (ii) the broker-dealer complies with the provisions of Rule 10b-10(b)(2) and Rule 10b-10(b)(3) that are applicable to money market funds that attempt to maintain a stable NAV referenced in Rule 10b-10(b)(1), and (iii) the broker-dealer has provided an initial written notification to the customer of such account of its ability to request delivery of immediate confirmations consistent with the written notification requirements of Exchange Act Rule 10b-10(a) and has not received such a request from the customer.

## **VI. Paperwork Reduction Act**

This Order contains "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995 ("PRA"). The Commission has submitted the information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507

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<sup>24</sup> 15 U.S.C. 78mm.

<sup>25</sup> 17 CFR 240.10b-10(f).

notification condition allows customers to obtain immediate confirmations should they choose to request them.

### **C. Respondents**

As stated in the Money Market Fund Reform Adopting Release, based on FOCUS report data as of December 31, 2013, the Commission estimates that there are approximately 320 broker-dealers that clear customer transactions or carry customer funds and securities.<sup>28</sup> In the Money Market Fund Reform Adopting Release, the Commission also conservatively estimated that those broker-dealers are the respondents that would provide trade confirmations to customers in institutional prime money market funds.<sup>29</sup>

### **D. Total Burden Estimates Relating to this Order**

The Commission estimates that the initial one-time burden required to implement, modify, or reprogram existing systems to generate and transmit the required notifications to customers would be 36 hours for each of the 320 broker-dealers that clear customer transactions or carry customer funds and securities.<sup>30</sup> Thus, the Commission estimates that the initial burden for issuance of the notifications in accordance with this Order, including burdens to implement, modify, or reprogram existing systems to generate such notifications will be approximately 11,520 burden hours.<sup>31</sup> The Commission anticipates that after broker-dealers incur the initial

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<sup>28</sup> Money Market Fund Reform Adopting Release, 79 FR at 47785 & n.563.

<sup>29</sup> *Id.*

<sup>30</sup> In the Money Market Fund Reform Adopting Release, the Commission estimated that the initial one-time burden to implement, modify, or reprogram existing systems to generate immediate confirmations (rather than monthly statements) would be 355 burden hours for each of the 320 broker-dealers that clear customer transactions or carry customer funds and securities. *Id.* at 47785 & n.562. Given the non-repeat nature of the notification requirement and substantial savings in resources noted by commenters, the Commission estimates that the burdens to develop system changes to provide the notices to all applicable customers would be no more than 10% of the prior 355 burden hours estimate associated with requiring immediate confirmations.

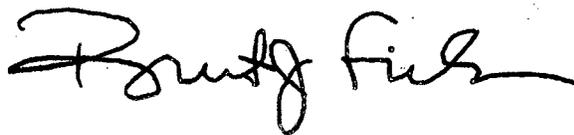
<sup>31</sup> This estimate is based on the following: 36 hours x 320 firms = 11,520 hours.

3. Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and

4. Evaluate whether there are ways to minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-08-14. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File No. S7-08-14, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE, Washington, DC 20549. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication in the Federal Register, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

By the Commission.



Brent J. Fields  
Secretary



owned subsidiary of Life Partners Holdings, Inc. ("LPHI"). In 2000, Peden became general counsel and secretary of LPHI and president of LPI.

2. On January 3, 2012, the Commission filed a complaint against Peden and others, including LPHI, in the United States District Court for the Western District of Texas ("the court") alleging that Peden violated Section 17(a)(1) of the Securities Act of 1933 ("the Securities Act"), Sections 10(b) and 13(b)(5) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 10b-5, 13b2-1 and 13b2-2 thereunder; and aided and abetted violations of Sections 10(b), 13(a) and 13(b)(2) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1 and 13a-13 thereunder. *SEC v. Life Partners Holdings, Inc., et al.*, Case Number 1:12-cv-33-JRN-AWA (Western District of Texas).

3. On February 3, 2014, following a trial on the complaint, a jury found that Peden had violated Section 17(a) of the Securities Act and aided and abetted violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder. The jury found in favor of Peden on the remaining charges. On March 12, 2014, the court set aside the jury's verdict under Section 17(a) of the Securities Act.

4. On January 16, 2015, the court entered a final judgment against Peden, based on the jury's finding that he aided and abetted LPHI in violating Section 13(a) and Rules 12b-20, 13a-1 and 13a-13 thereunder by filing Forms 10QSB, 10-Q, 10KSB and 10-K with the Commission that misrepresented, failed to disclose, and/or made misleading omissions regarding: (i) a material risk to LPHI's business; (ii) a material trend impacting LPHI's revenues; and/or (iii) LPHI's revenue recognition policies. The final judgment permanently enjoined Peden from future violations of Section 13(a) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder, and from aiding and abetting violations of Section 13(a) and Rules 12b-20, 13a-1 and 13a-13, and ordered him to pay a civil penalty of \$2,000,000. Peden has appealed the judgment against him to the United States Court of Appeals for the Fifth Circuit. The Commission has cross-appealed the court's decision to set aside the jury's verdict under Section 17(a)(1) of the Securities Act.

5. On April 16, 2015, pursuant to Rule 102(e)(3)(i)(A) of the Commission's Rules of Practice, the Commission instituted administrative proceedings and imposed a temporary suspension against Peden based on the January 16, 2015 judgment that permanently enjoins him from future violations of the federal securities laws.

6. On June 9, 2015, the Commission denied Peden's petition to lift the temporary suspension and scheduled the matter for a public hearing.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the suspension agreed to in Peden's Offer.

Accordingly, it is hereby ORDERED pursuant to Rule 102(e) of the Commission's Rules of Practice, effective immediately, that:

A. Peden is suspended from appearing or practicing before the Commission as an attorney for a term of forty-two months, commencing April 16, 2015, the date the Commission instituted administrative proceedings and imposed the temporary suspension in this matter.

B. After the forty-two month suspension has expired, Peden may request that the Commission consider his application to resume appearing and practicing before the Commission as an attorney. The application should be sent to the attention of the Office of the General Counsel.

C. In support of such an application, Peden must provide a certificate of good standing from each state bar of which he is a member.

D. In support of such an application, Peden must also submit an affidavit truthfully stating, under penalty of perjury:

1. that he is in compliance with the Commission's April 16, 2015 Order Imposing Temporary Suspension ("Order"), and in compliance with any orders in effect in *SEC v. Life Partners Holdings, Inc., et al.*, Case Number 1:12-cv-33-JRN-AWA (Western District of Texas), including any orders requiring payment of disgorgement or penalties;
2. that he:
  - a. is not currently suspended or disbarred as an attorney by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession; and
  - b. has not, since the entry of the Order, been suspended as an attorney for an offense involving moral turpitude by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession, except for any suspension concerning the conduct that was the basis for the Order and underlying civil action;
3. that since the entry of the Order, he has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice; and
4. that since the entry of the Order, he:

- a. has not been found by the Commission or a court of the United States to have committed a violation of the federal securities laws, except for any finding concerning the conduct that was the basis for the Order and underlying civil action;
- b. has not been charged by the Commission or the United States with a violation of the federal securities laws, except for any charge concerning the conduct that was the basis for the Order and underlying civil action;
- c. has not been found by a court of the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, to have committed an offense involving moral turpitude, except for any finding concerning the conduct that was the basis for the Order and underlying civil action; and
- d. has not been charged by the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, with having committed an offense involving moral turpitude, except for any charge concerning the conduct that was the basis for the Order and underlying civil action.

E. If Peden provides the documentation required in Paragraphs C and D, and the Commission determines that he truthfully attested to each of the items required in his affidavit, he shall by Commission order be permitted to resume appearing and practicing before the Commission as an attorney.

F. If Peden is not able to truthfully attest to the statements required in Subparagraphs D(2)(b) or D(4), he shall provide an explanation as to the facts and circumstances pertaining to the matter and the Commission may hold a hearing to determine whether there is good cause to permit him to resume appearing and practicing before the Commission as an attorney.

G. If the underlying district court judgment is modified on appeal, either Peden or the Office of the General Counsel may file a motion with the Commission to vacate or modify the suspension, as appropriate.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By Jill M. Peterson  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4276 / November 23, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16968**

**In the Matter of**

**JH PARTNERS, LLC,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS PURSUANT TO  
SECTIONS 203(e) AND 203(k) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against JH Partners, LLC ("Respondent" or "JHP").

**II.**

In anticipation of the institution of these proceedings, JHP has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, JHP consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that

#### Summary

These proceedings arise from negligent breaches of fiduciary duty by JHP, an investment adviser to several private equity funds (the "Funds"). From at least 2006 to 2012, JHP and certain of its principals loaned approximately \$62 million to the Funds' portfolio companies to provide interim financing for working capital or other urgent cash needs. By doing so, JHP and its principals in certain cases obtained interests in portfolio companies that were senior to the equity interests held by the Funds. JHP also caused more than one Fund to invest in the same portfolio company at differing priority levels and/or valuations, potentially favoring one Fund client over another. JHP did not adequately disclose to the advisory boards of the affected Funds the potential conflicts of interest created by the undisclosed loans and cross-over investments. Finally, JHP failed to adequately disclose to, or obtain written consent from, its client Funds' advisory boards when certain of their investments exceeded concentration limits in the Funds' organizational documents. Accordingly, JHP violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

#### Respondent

1. **JH Partners, LLC** ("JHP") is a Delaware limited liability company based in San Francisco, CA and has been registered with the Commission as an investment adviser since March 2012. JHP provides investment advice to three private equity funds, JH Investment Partners, L.P., JH Investment Partners II, L.P., and JH Evergreen Fund, L.P. As of March 31, 2015, JHP's total assets under management were \$465.4 million.

#### Other Relevant Entities

2. **JH Investment Partners, L.P.** ("Fund I"), **JH Investment Partners II, L.P.** ("Fund II"), and **JH Evergreen Fund, L.P.** ("Fund III" or "Evergreen Fund") (collectively, the "Funds") are Delaware limited partnerships formed in 2004, 2006, and 2008, respectively, with JHP as their investment adviser. The Funds' limited partners consisted of university endowments, other institutions, and high-net-worth individuals. The Funds primarily invested in lower to middle-market luxury consumer goods brands. A Delaware limited liability company that is under common control of JHP was named as each Fund's general partner in the Funds' organizational documents.

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

## **Background**

3. Formed in 2004, JHP advises and sources potential investments for its Funds that invest in lower and middle-market consumer products companies.

4. JHP's Funds pursue investment strategies that are focused on investing in buyouts, spinouts, recapitalizations and other opportunities in the U.S. and abroad. The Funds were given broad authority to carry out their investment activity and could acquire or trade securities of every kind, including stocks, notes, bonds, debentures, and other evidences of indebtedness.

5. The limited partners in JHP's private equity funds include university endowments and other large institutional investors and high-net-worth individuals. The limited partners commit and subsequently contribute a specified amount of capital to the Funds for their use to make qualifying investments during the investment period.

6. JHP charges its Funds a management fee, which was 2.5% of committed capital during the Funds' investment period. JHP's affiliated general partners also receive a carried interest of up to 20-25% of the net profits realized by the limited partners in the Funds.

7. An advisory board, consisting of the representatives from the endowment limited partners, was formed for each Fund to consult on new investments, resolve potential conflicts of interest, approve valuations, and provide oversight over JHP.

8. The Funds' Limited Partnership Agreements ("LPAs") require consent of the advisory board for any investments in portfolio companies by the general partner or its principals. According to the LPAs, consent of the advisory board is also required when the general partner, its principals, or their affiliates transfer securities or assets to the Funds.

## **Undisclosed Direct Loans to the Portfolio Companies**

9. From 2006 to 2012, JHP and certain of its principals provided nearly \$62 million in direct loans to the Funds' portfolio companies. By making these loans, JHP and its principals in certain cases obtained interests in portfolio companies that were senior to the equity interests held by the Funds. With few exceptions, JHP did not disclose to the Funds' advisory boards the existence of the direct loans or the potential conflicts of interest they created, nor did JHP obtain consent from the advisory boards.

10. For example, in one series of loans, JHP required a portfolio company to execute security agreements that pledged the assets of the company to JHP as collateral. The loans, which totaled \$2.9 million over a two-year period, funded the company's litigation against the founder and former CEO for allegedly violating his non-compete agreement.

## **Undisclosed Cross-Over Investments**

11. From 2007 to 2012, JHP also failed to adequately disclose that it caused more than

one fund to invest in the same portfolio company at differing seniority or priority levels and/or valuations, potentially favoring one Fund client over another.

12. For example, Fund II and the Evergreen Fund both invested in the equity of one portfolio company but the Evergreen Fund's equity interests were senior to those of Fund II and had a liquidation preference. In addition, the Evergreen Fund extended tens of millions of dollars in loans to the same portfolio company, further elevating the seniority of that Fund's security interests over the interests held by Fund II. JHP did not adequately disclose to, or seek consent from, Fund II's advisory board that the Evergreen Fund would be investing in the same portfolio company.

### **Undisclosed Overconcentration in Certain Portfolio Companies**

13. The Funds' LPAs provide that investments in any single company may not exceed 20% of each fund's committed capital without advisory board consent and that "in no event" may a single company investment exceed 30%. The LPAs also limit aggregate investments in foreign companies to 30% of Funds I and II and 50% of the Evergreen Fund. The LPAs further require that consents be documented by way of a written instrument with signatures from each advisory board member.

14. JHP, however, repeatedly exceeded the concentration limits without adequate disclosure or obtaining written consent. In one instance, Fund II invested over 30% of the committed capital in a foreign company, simultaneously violating two concentration limits, one for single company investments and another for foreign investments. Under the LPAs, exceeding the 30% limit for a single company investment could not be cured by advisory board consent but instead required a waiver by all limited partners. JHP did not seek the required waiver.

15. In addition, JHP caused the Funds to make a significant number of loans to the same portfolio companies that had already exceeded the concentration limits, without appropriate disclosure. Even though the loans increased the Funds' exposure to already overly-concentrated positions, JHP did not advise the advisory boards of this fact.

### **SEC Compliance Examination**

16. In January 2013, following an SEC examination, JHP disclosed the transactions described above to the advisory boards of the affected Funds. In March 2013, JHP agreed to subordinate (or place in equal footing) the direct loans to the Funds' investment interests. It also agreed to forego any rights to pursue repayment under the security agreements on certain loans, and has waived to date \$24 million in management fees and carried interest. As part of the March 2013 agreement, the advisory boards of the affected Funds consented in writing to the direct loans, cross-over investments and investments exceeding both single company and international concentration limits.

## Violations

17. Section 206(2) of the Advisers Act prohibits investment advisers from directly or indirectly engaging “in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.” A violation of Section 206(2) of the Advisers Act may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of *scienter* is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.* As a result of the conduct described above, JHP willfully violated Section 206(2) of the Advisers Act.<sup>2</sup>

18. Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder make it unlawful for any investment adviser to a pooled investment vehicle to “[m]ake any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle” or “engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.” As a result of the conduct described above, JHP willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

## JHP’s Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by JHP and cooperation afforded the Commission staff.

## IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, to impose the sanctions agreed to in Respondent JHP’s Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent JHP cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder.

B. Respondent JHP is censured.

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<sup>2</sup> A willful violation of the securities laws means merely “that the person charged with the duty knows what he is doing. It does not mean that, in addition, he must suppose that he is breaking the law.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). Instead, “it has been uniformly held that ‘willfully’ [in the securities law context] means intentionally committing the act which constitutes the violation,” and there is no requirement that the actor “also be aware that he is violating one of the Rules or Acts.” *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

C. Respondent shall, within 15 days of the entry of this Order, pay a civil money penalty in the amount of \$225,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying JH Partners, LLC as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Marshall Sprung, Co-Chief Asset Management Unit, Division of Enforcement, Los Angeles Regional Office, Securities and Exchange Commission, 444 South Flower Street, Suite 900, Los Angeles, CA 90071.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based

on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By **Jill M. Peterson**  
Assistant Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 4277 / November 23, 2015

ADMINISTRATIVE PROCEEDING  
File No. 3-16969

In the Matter of

CRANSHIRE CAPITAL  
ADVISORS, LLC,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTIONS 203(e) AND  
203(k) OF THE INVESTMENT ADVISERS  
ACT OF 1940, MAKING FINDINGS, AND  
IMPOSING REMEDIAL SANCTIONS AND A  
CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), against Cranshire Capital Advisors, LLC ("CCA" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### Summary

1. This proceeding involves an investment adviser that negligently: (i) charged expenses to its fund clients and (ii) failed to adopt and implement certain compliance policies and procedures. From 2012 through 2014, CCA advised five clients, including a private fund with a master/feeder structure (the "Fund"). During that period, CCA used Fund assets to pay for certain compliance, legal and operating expenses of CCA in a manner not disclosed in the Fund's offering memoranda and certain organizational documents. As a result, CCA breached its fiduciary duty to the Fund in violation of Section 206(2) of the Advisers Act and also violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. In addition, CCA failed to adopt policies and procedures with respect to allocation of Fund expenses and failed to implement other aspects of its compliance program. Accordingly, CCA also violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

#### Respondent and Other Entities

2. CCA is a Delaware limited liability company with its principal place of business in Northbrook, Illinois. CCA was registered with the Commission as an investment adviser from March 30, 2012, until March 28, 2015, when CCA withdrew its registration. Since at least May 22, 2015, CCA has operated as an exempt reporting adviser and on that date reported approximately \$94.4 million in assets under management ("AUM"). CCA still acts as adviser to the Fund, and both are being wound down.

3. Cranshire Capital Master Fund, Ltd., the Fund, was formed on March 21, 2011, as a Cayman Island exempted company and was organized for the purpose of investing assets received from a U.S. feeder fund, Cranshire Capital, L.P., and an offshore feeder fund, Cranshire Capital Offshore, Ltd. The Fund commenced operations on October 1, 2011, when Cranshire Capital, L.P. contributed \$176 million of assets and liabilities in return for shares in the Fund. The Fund is being wound down.

#### Background

4. In March 2012, CCA first registered with the Commission as an investment adviser and reported approximately \$204 million in AUM for five clients. CCA's clients included the Fund and two separately managed accounts. Investors in the Fund were individuals and entity limited partners ("the LPs"). CCA generally invested client assets in equities and warrants through

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

registered direct or private investment in public equity offerings and participation purchase agreements.

5. CCA and the Fund are both in the process of winding down. CCA has represented that within ninety (90) days of the entry of this Order, and subject to completion of the undertakings listed in paragraphs 18-20, CCA will sell all of the Fund's assets and the net proceeds from such sale will be distributed by the Fund to its shareholders, who are CCA's only other existing advisory clients (i.e., Cranshire Capital, L.P. and Cranshire Capital Offshore, Ltd.) (less a reserve for liquidation and dissolution costs and expenses), and each of such other advisory clients will in turn distribute the amounts received from the Fund to their respective limited partners and shareholders (less a reserve for liquidation and dissolution costs and expenses). CCA also has represented that as soon as practicable after such net proceeds are distributed and CCA has completed the process of transferring the assets so sold, it will close operations.

#### **CCA Negligently Allocated Expenses to the Fund**

6. Investments in the Fund are primarily governed by a private placement memorandum ("PPM") and the Fund's limited partnership agreement ("LPA") and an Omnibus Management Agreement ("Management Agreement").

7. From 2012 through 2014, CCA used the Fund's assets to pay for certain CCA legal, compliance and operating expenses in a manner that was not disclosed in the Fund's organizational documents.

8. CCA's PPM and the Fund's LPAs both disclosed that CCA would "provide the [Fund] with office space and utilities. The [Fund] will pay all its other expenses, including . . . legal and accounting fees." Similarly, the Management Agreement effective March 1, 2012 provided that CCA would render its services to the Fund "at its own expense, including, without limitation, operating expenses (such as rent for office space and telephone lines) . . . unless such expenses are otherwise expenses to be borne by the Funds as described above . . ." Regarding legal and compliance expenses, the Management Agreement stated only that "each Fund shall bear its own expenses, including . . . external legal expenses."

9. None of these provisions authorized CCA to charge the Fund for its own compliance consulting fees. From 2012 through 2014, CCA employed an outside attorney to serve as a compliance consultant to advise it on registration and compliance matters. The services provided by the consultant related to the creation and operation of CCA's compliance program rather than any investments or operations of the Fund. During this period, CCA improperly used \$158,650 in Fund assets to pay the consultant's fees.

10. Despite the clear disclosures regarding operating expenses, from 2011 to 2014 CCA also improperly used \$118,378 in Fund assets to pay costs associated with its office supplies, computers, and utilities.

## CCA Failed to Adopt and Implement Compliance Procedures

11. The improper allocation of expenses to the Fund was caused in part by CCA's failure to adopt and implement an adequate compliance program. CCA's compliance manual, adopted as a result of registering with the Commission, did not include a policy or procedure for determining when a particular item was properly chargeable to the Fund. CCA also failed to implement additional compliance procedures as described below.

12. CCA's compliance manual provided that "[t]he Funds' accounts are also reviewed on a regular basis by a third party administrator to price the portfolio based on independent third party pricing sources or methodologies approved by [CCA]. . . . The third party administrator also ensures that [CCA's] records are in agreement with those of its custodian." In reality, only CCA and not the third party administrator was pricing the portfolio and reconciling CCA's accounts.

13. CCA's compliance manual also provided that all CCA employees would report their personal securities holdings and that these holdings and transaction reports would be reviewed to monitor for any conflicts that could arise from personal trading. In reality, the person conducting these reviews did not review trades placed for the Fund, and his review of personal securities holdings was limited to brokerage account statements and securities separately reported to him. Because of this lapse, on one occasion where a private securities holding was not reported, CCA neglected to identify a potential conflict arising from the fact that the Fund invested in stock that a CCA officer already owned but did not hold in a brokerage account.

## Violations

14. Section 206(2) of the Advisers Act prohibits investment advisers from directly or indirectly engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." As a result of the conduct described above, Respondent willfully<sup>2</sup> violated Section 206(2) of the Advisers Act. A violation of Section 206(2) does not require a showing of scienter but "may rest on a finding of simple negligence." SEC v. Steadman, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing SEC v. Capital Gains Research Bureau Inc., 375 U.S. 180, 191 (1963)).

15. Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder make it unlawful for any investment adviser to a pooled investment vehicle to "[m]ake any untrue statement of a material fact or omit to state a material fact necessary to make the statement made, in light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle" or "engage in any act, practice or course of business that is

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<sup>2</sup> A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.” As a result of the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. A showing of negligence is also sufficient to establish a violation of Section 206(4) of the Advisers Act or Rule 206(4)-8 thereunder. Steadman, 967 F.2d at 647.

16. Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder require a registered investment adviser to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules, and to review, no less frequently than annually, the adequacy of the policies and procedures and the effectiveness of their implementation. As a result of the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

#### **Remedial Efforts**

17. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff. With respect to CCA’s compliance program specifically, CCA, through its counsel, engaged a new compliance consultant in the Fall of 2014 to evaluate and give guidance to CCA on its compliance practices and procedures. With the assistance of the new consultant, CCA has implemented a variety of changes to its compliance program, including but not limited to revising its expense allocation policy to include the involvement of CCA’s CCO. In addition, at various stages CCA reimbursed the Fund for expenses identified in this Order.

#### **Undertakings**

18. Compliance Consultant. CCA shall retain at all times from the entry of this Order through the date at which it no longer has assets under management the services of the new consultant hired in the Fall of 2014 (the “Consultant”). The Consultant’s compensation and expenses shall be borne exclusively by CCA. The Consultant shall report solely to the CCO.

19. Notice of Order. Within thirty (30) days of the entry of this Order, CCA shall provide a copy of the Order to each of the limited partners and shareholders of Cranshire Capital, L.P. and Cranshire Capital Offshore, Ltd., respectively, as of the entry of this Order via mail, e-mail, or such other method as may be acceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff.

20. Certification of Compliance. CCA will certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Amy Cotter, Assistant Regional Director, with a copy

to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

#### IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-8 and 206(4)-7 promulgated thereunder.

B. Respondent is censured.

C. Respondent shall, within fourteen (14) days of the entry of this Order, pay a civil money penalty in the amount of \$250,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payment by check or money order must be accompanied by a cover letter identifying CCA as Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Amy Cotter, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, Chicago Regional Office, 175 West

Jackson Boulevard, Suite 900, Chicago, IL 60604, or such other address the Commission staff may provide.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

E. Respondent shall comply with the undertakings enumerated in Section III, Paragraphs 18-20 above.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: Jill M. Peterson  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 76512 / November 24, 2015**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4279 / November 24, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16970**

**In the Matter of**

**MARWOOD GROUP RESEARCH, LLC,**

**Respondent.**

**ORDER INSTITUTING CEASE-AND-DESIST  
PROCEEDINGS PURSUANT TO SECTION  
21C OF THE SECURITIES EXCHANGE ACT  
OF 1934 AND SECTION 203(k) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS AND IMPOSING  
REMEDIAL SANCTIONS AND CEASE-AND-  
DESIST ORDER**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Marwood Group Research, LLC ("Marwood").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Respondent admits the facts set forth in Section III, B and C, below, acknowledges that its conduct violated the federal securities laws, admits the Commission's jurisdiction over it and the subject matter of these proceedings, and consents to entry of this Order Instituting Cease-and Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 203(k) of the Investment Advisers Act of 1940, Making Findings and Imposing Remedial Sanctions and Cease-and-Desist Order ("Order"), as set forth below.

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### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that

#### A. Summary

Marwood, a regulatory and legislative policy firm ("a political intelligence firm"), and registered broker-dealer, as well as a state-registered investment adviser, in 2010 failed to establish, maintain and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information ("MNPI") consistent with the nature of its business. Section 15(g) of the Exchange Act requires broker-dealers to establish, maintain, and enforce written policies and procedures, consistent with the nature of their business, to prevent the misuse of MNPI. Section 204A of the Advisers Act provides a similar requirement for investment advisers. Broker-dealers and investment advisers must adopt and enforce policies and procedures that take into consideration the specific circumstances of their businesses. *See In re Gabelli & Co., Inc.*, Exchange Act Rel. No. 35057 (Dec. 8, 1994). During 2010, Marwood did not adopt a policy reasonably tailored to its business, and it failed reasonably to enforce the policy that it did have in place.

One aspect of Marwood's business was providing regulatory and policy updates ("research notes") to hedge funds and other securities market participants concerning likely outcomes of future government actions. Marwood encouraged its employees to maintain relationships with government employees to develop information to inform such research notes. In this context, Marwood's analysts would meet with, call and otherwise communicate with the relevant government actors, who were often in possession of potential MNPI. These interactions created a substantial risk for MNPI to be obtained and misused, and necessitated the establishment and enforcement of reasonable procedures to ensure against such misuse.

During 2010, Marwood sought and received from government employees information about pending regulatory or policy issues involving the agencies that employed them. Some of the information, in the context in which it was conveyed, presented a substantial risk that it could be MNPI. Based in part on that information, Marwood drafted research notes and distributed those research notes to its clients, or otherwise communicated Marwood's conclusions to its clients, who were likely using that information to inform securities trading.

Marwood had written policies and procedures that prohibited the dissemination of MNPI and required any potential MNPI received from any source to be brought to the attention of the Chief Compliance Officer ("CCO"). During 2010, the receipt of potential MNPI was not brought to the attention of the CCO. Moreover, Marwood's policies and procedures were not reasonably designed, given the nature of Marwood's business, including its employees' contact

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

and interaction with government employees in possession of potential MNPI. *See id.*; *In re Massachusetts Fin. Servs. Co.*, Advisers Act Rel. No. 2165 (September 4, 2003); *In re Guy P. Wyser-Pratt*, Exchange Act Rel. No. 44283 (May 9, 2001). During 2010, Marwood therefore failed to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of MNPI, as required of registered broker-dealers and investment advisers.

## **B. Respondent and Other Relevant Entities**

### **Respondent**

1. **Marwood Group Research, LLC**, was founded in 2003 and has its principal place of business in New York, NY, and an office in Washington D.C. A New York limited liability company, Marwood is a broker-dealer, registered with the Commission and an investment adviser registered with the State of New York. Since its founding, Marwood's business has included, among other things, providing research and analysis to clients as to the likely outcome of legislative and regulatory events occurring at both state and federal levels.

### **Other Relevant Entities**

2. **The Centers for Medicare and Medicaid Services ("CMS")** is a federal agency within the U.S. Department of Health and Human Services. CMS is responsible for the administration and management of Medicare and Medicaid.

3. **The Food and Drug Administration ("FDA")** is a federal agency within the U.S. Department of Health and Human Services. Among other things, the FDA evaluates and approves drugs and medical devices prior to their marketing and sale within the United States.

## **C. Facts**

### *i. Marwood's Regulatory and Legislative Research Business*

4. Since its founding, Marwood's business has been to research and write reports and updates, and otherwise communicate information concerning regulatory and legislative issues. Marwood's initial focus was on healthcare, but it has expanded into other areas such as tax and education. Marwood sells its analysis to clients in the financial sector. For Marwood, "legislative and regulatory policy catalysts" were events that had the potential to affect the share price of a public company's stock or stocks within a particular market sector. Marwood emphasized its ability to provide value to clients through "tracking, analyzing and forecasting investment catalysts." Marwood distributed its reports, updates and other communications to its subscriber clients, which were predominantly mutual funds, investment advisers and hedge funds.

5. Marwood's research and policy analysts were based in its Washington, D.C. office. Marwood's New York office housed Marwood's account representatives, who were responsible for managing the relationships with Marwood's clients.

6. Account representatives communicated Marwood's research and work-product to clients. Account representatives also participated in the drafting of Marwood's published research

and took an active role in the sale and marketing of Marwood's research. Marwood's account representatives and managers highlighted Marwood's successes to current or prospective clients, and highlighted Marwood's relationships with, and connections to, government decision makers.

ii. *Marwood's Research Notes*

7. One of Marwood's principal means of communicating with clients was through research notes. Marwood's research notes often included previews of anticipated legislative or regulatory developments and post-views of government actions already undertaken. Preview notes often included a predictive opinion of the likely outcome of government activity. Post-view notes summarized government activity that had already occurred and reiterated prior opinions or offered new opinions about the implications of the government action.

8. To enhance Marwood's ability to write research opining on future government regulatory events, Marwood encouraged its analysts to maintain contacts and seek information from personnel within the federal government.

9. Marwood also arranged meetings and phone calls with government employees that sometimes included representatives of their clients. During these meetings and calls, Marwood employees sought and obtained information from the government employees, which Marwood then, at times, used to inform its research. During 2010, as described below, some of the information obtained, in the context in which it was conveyed, presented a substantial risk that it could be MNPI. Marwood's managers were aware of such calls and meetings, and they actively promoted them. Additionally, Marwood used outside consultants, including individuals who previously were government or agency officials, to inform its research.

10. Marwood's research notes were formulated, drafted and edited by analysts in Marwood's Washington, D.C. office, and, at times in conjunction with account representatives from the New York office. Once Marwood came to a conclusion about a future legislative or regulatory event, an analyst or account representative (or perhaps both working together) would draft and circulate a research note setting forth the analysis. These notes were generally brief, with a few paragraphs describing the opinion and several paragraphs of background information about the particular government event or regulatory activity.

11. In 2010, in addition to its written policies and procedures concerning the use and dissemination of inside information, which included material nonpublic information, Marwood's policies and procedures provided for a review process over the preparation and publication of its regulatory and legislative research notes. The policies and procedures required a review and approval by a licensed supervisory principal and submission of the reviewed material through the compliance department. Furthermore, when an employee had any doubt as to whether information in his or her possession constituted inside information, he or she was required to refrain from communicating it further and promptly contact Marwood's compliance department. Although each publication was required to be reviewed for the possible inappropriate dissemination of material nonpublic information to an outside party, during 2010, Marwood's policies and procedures did not expressly require the compliance department to be advised as to

the source of the information included in the research note or about communications with government sources, if any.

12. Research notes were distributed to Marwood clients by account representatives in Marwood's New York office. After distribution, Marwood's account representatives reached out by phone or email to clients who were known to have an interest in the subject of the note, including clients likely to trade the securities of the company whose product or service could be impacted by impending government activity.

13. During these follow up phone calls and emails, Marwood's account representatives sometimes arranged further communications between the clients and the Marwood analysts responsible for the research note. During these subsequent communications, Marwood employees sometimes disclosed that the information that formed the basis of the research note came from government employees.

14. Marwood's research notes often opined on the future actions of government agencies, including the anticipated timing and content of agency rules and decisions.

15. Marwood managers encouraged Marwood's analysts to contact relevant government officials to aid their research efforts. In making hiring decisions, Marwood also considered, in part, a prospective employee's professional experience at a particular agency as well as contacts within the government.

*iii. Marwood's Managers Failed Reasonably to Enforce Marwood's Existing Policy*

16. During 2010, Marwood had a written insider trading policy that prohibited its employees from using or disclosing any MNPI if they had obtained such information in the course of their employment. The policy specifically identified as potential MNPI "knowledge or awareness of the specific terms of any pending but not yet publicly proposed or approved action by a regulatory or other government agency." The Marwood policy further stated that if an employee had *any* doubt as to whether he or she had obtained MNPI from any source, the employee was to refrain from using or disclosing the MNPI, and was to consult with Marwood's compliance department.

17. Marwood's analysts' interaction with government employees resulted in Marwood's obtaining information, given the context in which it was conveyed, that should have caused Marwood's managers to quarantine the information and seek guidance from Marwood's CCO. No instances were brought to the attention of the CCO during 2010.

a. The Provenge National Coverage Analysis

18. CMS has the authority to determine what medical items and services will be covered for Medicare beneficiaries and at what reimbursement rates. For certain medical items and services, CMS may make a National Coverage Determination ("NCD") to determine the criteria for coverage of that item or service on a national basis for all Medicare beneficiaries. The process that leads to an NCD is often referred to as a National Coverage Analysis ("NCA").

19. The goal of an NCA is to determine whether an item or service is “reasonable and necessary” for the diagnosis or treatment of a specific illness or injury. Because such a determination can change Medicare coverage, the announcement of an NCD can be a material event that reduces or enhances the market value of the securities of public companies offering the medical item or service.

20. Although CMS staff were permitted to speak to the public on various topics, they were governed by a confidentiality policy and agency regulations as to what information they could disclose.

21. Marwood’s CMS analyst during the summer of 2010 was a former employee of CMS, who had previously worked in the CMS group responsible for NCAs.

22. On June 30, 2010, CMS opened an NCA to determine whether or not Provenge—an immunotherapy approved by the FDA in April 2010 for treatment of metastatic prostate cancer—was “reasonable and necessary” for Medicare beneficiaries. Immediately upon the NCA announcement there was a sharp drop in the share price of the common stock of the company that developed Provenge. The NCA raised the possibility that Medicare might deny reimbursement for Provenge completely, *i.e.*, even if Provenge were prescribed in a manner consistent with the FDA approved label, which could affect the company’s financial performance.

23. After announcement of the NCA, some Marwood clients sought Marwood’s views on why the NCA had been initiated and its likely outcome. In a June 30, 2010 email, Marwood’s CMS analyst told his manager that he knew one of several CMS employees (the “CMS contact”) listed on the NCA tracking sheet issued by CMS announcing the nature and scope of the review from whom he could obtain “decent color” on why the NCA had been initiated.

24. On July 7, 2010, Marwood’s CMS analyst successfully contacted and spoke with the CMS contact. Later that afternoon, the CMS analyst emailed to, among others, his manager and a handful of account representatives as follows:

I was able to speak with [the CMS contact] working on this, and [the CMS contact] was clear that this is being looked at both due to local contractor concerns and potential questions around the data, and specifically uses outside the data. The [CMS contact] also mentioned that CMS has gotten inquiries from patient groups, providers, and advocacy groups on this issue. Lastly, [the CMS contact] was clear that I’m the only phone call [the CMS contact] returned so if any of this leaks out [the CMS contact] will know where it came from. [T]his is good color, but please keep the sensitivity of this in mind when talking to clients because any leakage of this info will result in my getting locked out of any conversations going forward.

This email, which the analyst interpreted to express concern for off-label use and further the belief that CMS would cover on-label use, was forwarded to two other Marwood managers later that day.

25. Given the Marwood analyst's comments about the sensitivity of his contact with CMS, the information that the Marwood analyst obtained from the CMS contact, in the context in which it was conveyed, presented a substantial risk that it could be MNPI.

26. None of the Marwood staff or managers who received copies of the CMS analyst's email took steps to present the information to the CCO for further review. On July 8, 2010, Marwood published a research note on this topic to hundreds of Marwood clients. The research note predicted CMS's continued coverage and reimbursement of Provenge's on-label usages, and was entitled, in part "*Provenge NCA Likely to Support On-Label Coverage.*"

b. The Bydureon New Drug Application

27. Bydureon is an injectable diabetes drug, developed jointly by a partnership of three pharmaceutical companies, one of which acted as Bydureon's sponsor before the FDA, and took the lead in seeking government approval to market and sell the drug within the United States.

28. The sponsoring company submitted a new drug application for Bydureon to the FDA on May 4, 2009. On April 22, 2010, the sponsoring company submitted a revised new drug application to address some concerns raised by the FDA. In response to the refiling, the FDA set a new statutory decision deadline of October 22, 2010.

29. Some of Marwood's clients sought Marwood's view of the likely outcome of the FDA's decision.

30. Throughout 2010, Marwood had retained as a consultant a former high ranking FDA official to assist with its analysis of FDA issues, which included the Bydureon new drug application, among other topics. On September 14, 2010, the consultant and certain Marwood employees had a 73 minute phone call during which they discussed the consultant's views on the Bydureon new drug application. According to one Marwood employee's lengthy notes of the call, the consultant told Marwood that "contacts @ agency were saying that some @ agency still concerned about approval" and that there was a "debate between safety and reviewers." The consultant further told them several specific safety issues about which he believed the FDA was purportedly debating. As captured in the Marwood employee's notes, this information from the consultant, in the context in which it was conveyed, presented a substantial risk of being MNPI and should have been presented to the CCO for further review.

31. No Marwood staff or managers took any steps to quarantine the information received from the consultant or to alert the CCO.

32. Between September 14, 2010, and October 19, 2010, Marwood communicated the information it obtained from the consultant to its clients by email and orally. Marwood informed its clients that there was an internal debate at the FDA concerning the safety of Bydureon and that there was an under-appreciated risk in the market that the application could be denied.

v. *Marwood's Policy Was Not Reasonably Designed to Address the Risks Created by Its Business*

33. As noted above, Marwood had a general policy that prohibited the acquisition and misuse of MNPI. Marwood's policies and procedures provided that employees who acquired confidential information, which included MNPI, were required to bring it to the attention of the compliance department, which would determine whether the information could be used.

34. Marwood's analysts interacted with government employees who were likely to be in possession of potential MNPI, and Marwood's management encouraged such contacts. Marwood used information gained from such contacts in formulating research notes that were distributed to clients. Despite the significant risk that this interaction could result in Marwood receiving MNPI, Marwood had no written policy or procedure that reasonably ensured that the CCO was provided with sufficient information to assess whether a research note may have been influenced by improperly obtained MNPI or to evaluate independently other Marwood employees' assessments that any information they had received from a government employee was not MNPI. Instead, Marwood's policy principally relied on line employees and managers to make this assessment, with limited review by the CCO.

35. The Commission has previously noted that if the nature of a particular broker-dealer's or investment adviser's business exposes employees to persons in possession of MNPI on a regular basis, a general policy that those employees self-evaluate information they receive is insufficient to comply with Section 15(g) of the Exchange Act and Section 204A of the Advisers Act. *In re Gintel, Asset Mgmt. Inc.*, Advisers Act Rel. No. 2079 (November 8, 2002); *In re Deprince, Race & Zollo, Inc.*, Advisers Act Rel. No. 2035 (June 12, 2002); *In re Guy P. Wyser-Pratte*, Advisers Act Rel. No. IA-1943 (May 2, 2001); *In re Certain Market Making Activities on Nasdaq*, Exchange Act Rel. No. 40910 (January 11, 1999).

36. Consequently, Marwood's written policies and procedures failed to address the substantial risk that its analysts who were in contact with government employees likely to be in possession of potential MNPI, could obtain and disseminate MNPI to Marwood's clients, who were likely to use that information to inform their securities trading. As a result, Marwood's written policies and procedures were not reasonably designed to address the risks associated with the nature of its business activities. As noted above, Marwood's policies in this regard were also not reasonably enforced.

**D. Violations**

37. As a result of the conduct described above, Marwood violated Section 15(g) of the Exchange Act, which requires every registered broker or dealer to "establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such broker's or dealer's business, to prevent the misuse in violation of... [the Exchange Act]

or the rules or regulations thereunder, of material nonpublic information by such broker or dealer or any person associated with such broker or dealer.”<sup>2</sup>

38. As a result of the conduct described above, Marwood violated Section 204A of the Advisers Act, which requires every investment adviser to “establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such investment adviser’s business, to prevent the misuse in violation of...[the Advisers Act or the Exchange Act] or the rules and regulations thereunder, of material nonpublic information by such investment adviser or any person associated with such investment adviser.”

#### **E. Remedial Efforts**

39. In determining to accept the Offer, the Commission considered the remedial acts promptly undertaken by Marwood, including the voluntary and proactive enhancing of its policies and procedures in 2013 and 2014 governing the potential misuse of material nonpublic information.

#### **F. Undertakings**

40. Independent Compliance Consultant. Marwood undertakes to retain an Independent Compliance Consultant (“Compliance Consultant”) as follows:

a. Marwood shall retain, within 60 days of this Order, at its expense, a Compliance Consultant not unacceptable to the Commission’s staff, to conduct a review of the enforcement of Marwood’s supervisory, compliance, and other policies and procedures under Section 15(g) of the Exchange Act and Section 204A of the Advisers Act, insofar as they relate to the obtaining or use of potential Material Non-public Information (“MNPI”).

b. Marwood shall provide to the Commission staff, within thirty (30) days of retaining the Compliance Consultant, a copy of an engagement letter detailing the Compliance Consultant’s responsibilities, which shall include reviews to be made by the Monitor as described in this Order. The Compliance Consultant’s responsibilities shall include the review of Marwood’s enforcement of its policies and procedures regarding the obtaining and use of potential MNPI.

c. Marwood shall require that, within forty five (45) days from the end of the Compliance Consultant’s Review, which in no event will be more than 180 days after the date of the Monitor’s retention, the Compliance Consultant shall submit a written and dated report of its findings to Marwood and to the Commission staff (the “Report”). Marwood

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<sup>2</sup> There is no requirement under Section 15(g) that there be an underlying insider trading violation or any other violation of the Exchange Act or the rules thereunder. *In the Matter of Monness, Crespi, Hardt & Co., Inc.*, Exchange Act Release No. 72886, 2014 WL 4090466, at \*4, n. 3 (Aug. 20, 2014); *In the Matter of New York Stock Exchange LLC, et al.*, Exchange Act Rel. No. 72065, 2014 SEC LEXIS 1526 (May 1, 2014); *In the Matter of Certain Market Making Activities on NASDAQ*, Exchange Act Rel. No. 40910, 1999 SEC LEXIS 59 (Jan. 11, 1999).

shall require that the Report include a description of the review performed, the names of individuals who performed the review, the conclusions reached, any recommendations for changes in or improvements to the enforcement of Marwood's policies and procedures and a procedure for implementing the recommended changes in or improvements to the enforcement of Marwood's policies and procedures.

d. Marwood shall adopt all recommendations contained in the Report within ninety (90) days of the Report; provided, however, that within forty-five (45) days after the date of the Report, Marwood shall in writing advise the Compliance Consultant and the Commission staff of any recommendations that Marwood considers to be unduly burdensome, impractical, or inappropriate. With respect to any recommendation that Marwood considers unduly burdensome, impractical, or inappropriate, Marwood need not adopt that recommendation at that time but shall propose in writing an alternative enforcement mechanism designed to achieve the same objective or purpose.

e. As to any recommendation with respect to the enforcement of Marwood's policies and procedures on which Marwood and the Compliance Consultant do not agree, Marwood and the Compliance Consultant shall attempt in good faith to reach an agreement within sixty (60) days after the date of the Report. Within fifteen (15) days after the conclusion of the discussion and evaluation by Marwood and the Compliance Consultant, Marwood shall require that the Compliance Consultant inform Marwood and the Commission staff in writing of the Compliance Consultant's final determination concerning any recommendation that Marwood considers to be unduly burdensome, impractical, or inappropriate. Within 15 days of this written communication from the Compliance Consultant, Marwood may seek approval from the Commission staff to not adopt recommendations that Marwood can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Marwood shall not be required to abide by, adopt, or implement those recommendations.

f. Marwood shall cooperate fully with the Compliance Consultant and shall provide access to such of its files, books, records, and personnel as are reasonably requested by the Compliance Consultant for review.

g. To ensure the independence of the Compliance Consultant, Marwood shall not have the authority to terminate the Compliance Consultant or substitute another independent compliance consultant without the prior written approval of Commission staff, and (2) shall compensate the Compliance Consultant for services rendered pursuant to this Order at their reasonable and customary rates.

h. Marwood shall require the Compliance Consultant to enter into an agreement that provides that for the period of engagement and for a period of two (2) years from completion of the engagement, the Compliance Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Marwood, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Compliance

Consultant will require that any firm with which the Compliance Consultant is affiliated or of which the Monitor is a member, and any person engaged to assist the Compliance Consultant's performance of its duties under this Order shall not, without written prior consent of Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Marwood, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of engagement and for a period of two (2) years after the engagement.

41. Recordkeeping. Marwood shall preserve for a period of not less than six (6) years from the end of the fiscal year last used, the first two (2) years in an easily accessible place, any record of Marwood's compliance with the undertakings set forth in this Order.

42. Deadlines. For good cause shown, the Commission staff may extend any of the procedural dates relating to the undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered the last day.

43. Certifications of Compliance by Marwood. Marwood shall certify, in writing, compliance with its undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Marwood agrees to provide such evidence. The certification and supporting material shall be submitted to William P. Hicks, Associate Regional Director of the Atlanta Office of the Commission, 950 East Paces Ferry Road, Suite 900, Atlanta, Georgia 30326 no later than sixty (60) days from the date of the completion of the undertakings.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act and Section 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Marwood cease and desist from committing or causing any violations and any future violations of Section 15(g) of the Exchange Act and Section 204A of the Advisers Act.

B. Respondent Marwood shall pay a civil money penalty in the amount of \$375,000 to the Commission. Payment shall be made in the following installments: \$93,750 shall be paid within 10 days of the entry of this order; an additional \$93,750 shall be paid within 120 days of the entry of this order; an additional \$93,750 shall be paid within 240 days of the entry of this order; and a final \$93,750 shall be paid within 360 days of this order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of the civil penalty shall be due and payable immediately, without further application. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying the party making payment as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must also be sent to William P. Hicks, Associate Regional Director of the Atlanta Office of the Commission, 950 East Paces Ferry Road, Suite 900, Atlanta, Georgia 30326.

C. Respondent Marwood shall comply with the undertakings enumerated in Section III, paragraphs 40 through 43, above.

By the Commission.

Brent J. Fields  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 4281 / November 24, 2015

Admin. Proc. File No. 3-15925

In the Matter of

MICHAEL S. STEINBERG

ORDER DISMISSING PROCEEDING

On November 4, 2014, Michael S. Steinberg appealed an initial decision by an administrative law judge barring him from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.<sup>1</sup> The follow-on administrative proceeding was instituted against Steinberg under Section 203(f) of the Investment Advisers Act of 1940 based on his criminal conviction for insider trading.<sup>2</sup> We subsequently postponed briefing on Steinberg's petition for review in light of developments in the related case of *United States v. Newman*.<sup>3</sup> On October 30, 2015, a district judge in the United States District Court for the Southern District of New York vacated Steinberg's conviction and dismissed the indictment against him.<sup>4</sup>

<sup>1</sup> *Michael S. Steinberg*, Initial Decision Release No. 690, 2014 WL 5141532 (Oct. 14, 2014), *petition for review granted*, Exchange Act Release No. 73700, 2014 WL 6680114 (Nov. 26, 2014).

<sup>2</sup> *See United States v. Steinberg*, No. 1:12-cr-00121 (RJS) (S.D.N.Y. Dec. 18, 2013).

<sup>3</sup> *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), *cert. denied*, \_\_\_ S. Ct. \_\_\_, 2015 WL 4575840 (Oct. 5, 2015); *see Michael S. Steinberg*, Advisers Act Release No. 4008, 2015 WL 331125 (Jan. 27, 2015) (postponement order). Prior to our granting a postponement, we also granted two extensions of the briefing schedule. *See Michael S. Steinberg*, Exchange Act Release No. 73915, 2014 WL 7271549 (Dec. 22, 2014) (first extension); *Michael S. Steinberg*, Exchange Act Release No. 74014, 2015 WL 107083 (Jan. 8, 2015) (second extension).

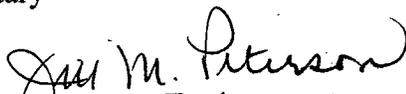
<sup>4</sup> *See United States v. Steinberg*, No. 1:12-cr-00121 (RJS) (S.D.N.Y. Oct. 30, 2015).

Steinberg now requests that we convert his petition for review into a motion to dismiss in light of the vacated criminal conviction.<sup>5</sup> He supports his request by asserting that the basis for the bar no longer exists. The Division of Enforcement does not oppose his request. Given the subsequent judicial developments, we find that it is appropriate to grant Steinberg's request.<sup>6</sup>

Accordingly, it is ORDERED that the administrative proceeding against Michael S. Steinberg is dismissed.<sup>7</sup>

By the Commission.

Brent J. Fields  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary

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<sup>5</sup> We previously have converted petitions for review into motions to dismiss in similar circumstances, *see, e.g., Anthony Chiasson*, Advisers Act Release No. 4085, 2015 WL 2328706 (May 15, 2015); *Richard L. Goble*, Exchange Act Release No. 68651, 2013 WL 150557 (Jan. 14, 2013), and do so again here.

<sup>6</sup> *See, e.g., Chiasson*, 2015 WL 2328706, at \*1 (dismissing follow-on proceeding after court vacated predicate conviction and injunction); *Jilaine H. Bauer, Esq.*, Exchange Act Release No. 70631, 2013 WL 5533144 (Oct. 8, 2013) (dismissing Rule 102(e) disciplinary proceeding after court of appeals reversed predicate district court judgment); *Goble*, 2013 WL 150557, at \*1-2 (dismissing follow-on proceeding after court vacated predicate injunction); *Evelyn Litwok*, Advisers Act Release No. 3438, 2012 WL 3027914 (July 25, 2012) (dismissing follow-on proceeding after court reversed predicate convictions).

<sup>7</sup> Steinberg also requests that we reverse the administrative law judge's decision, but that decision already "ceased to have any force or effect" once we granted his petition for review. *Steven Altman, Esq.*, Exchange Act Release No. 63665, 2011 WL 52087, at \*2 (Jan. 6, 2011).

SECURITIES AND EXCHANGE COMMISSION  
Release No. 34-76514; File Nos. 600-33, 600-34

November 24, 2015

Bloomberg STP LLC; SS&C Technologies, Inc.; Order of the Commission Approving Applications for an Exemption from Registration as a Clearing Agency

I. Introduction

On March 15, 2013, Bloomberg STP LLC (“BSTP”) filed with the Securities and Exchange Commission (“Commission”) an application on Form CA-1 for an exemption from registration as a clearing agency (“BSTP application”) pursuant to Section 17A of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 17Ab2-1 thereunder. BSTP amended the BSTP application on May 7, 9, and 10, July 11, August 8, September 18, and November 21, 2013, December 19, 2014, and January 22, 2015.<sup>1</sup> BSTP intends to provide a matching service<sup>2</sup> and an electronic trade confirmation (“ETC”) service, and accordingly the BSTP application seeks an exemption from registration as a clearing agency. Notice of the BSTP application was published for comment in the Federal Register on March 5, 2015.<sup>3</sup>

On April 15, 2013, SS&C Technologies, Inc. (“SS&C”) filed with the Commission an application on Form CA-1 for an exemption from registration as a clearing agency (“SS&C application”) pursuant to Section 17A of the Exchange Act and Rule 17Ab2-1 thereunder. SS&C amended the SS&C application on August 12, 2013, December 23, 2014, March 30, 2015,

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<sup>1</sup> A copy of the BSTP application is available at <http://www.sec.gov/rules/other/2015/34-74394-form-ca-1.pdf>.

<sup>2</sup> The term “matching service” as used herein means an electronic service to centrally match trade information between a broker-dealer and its institutional customer.

<sup>3</sup> See Exchange Act Release No. 34-74394 (Feb. 27, 2015), 80 FR 12048 (Mar. 5, 2015) (“BSTP notice”).

and November 9, 2015.<sup>4</sup> SS&C intends to provide a matching and ETC service, and accordingly the SS&C application seeks an exemption from registration as a clearing agency.<sup>5</sup> Notice of the SS&C application was published for comment in the Federal Register on April 28, 2015.<sup>6</sup>

In all, the Commission received thirty comment letters in response to the BSTP and SS&C applications. Among these comment letters, the Commission received twenty-seven in response to the BSTP application, including two from BSTP itself, and three comment letters on the SS&C application, including one from SS&C itself.<sup>7</sup> After careful review of these comment

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<sup>4</sup> A copy of the SS&C application is available at <http://www.sec.gov/rules/other/2015/34-74794-form-ca-1.pdf>. The November 9, 2015 amendment to the SS&C application removed the representation that SS&C would notify the Commission and seek a volume limit amendment to its Form CA-1 at least 180 days before it anticipates its volume for U.S. securities matched to reach one percent of the U.S. aggregate daily share volume. See *infra* Part III.B.4.iv.

In addition, in the November 9, 2015 amendment SS&C replaced a representation stating that SS&C shall comply with the White Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System before its volume for U.S. securities matched is 1% of the U.S. aggregate daily share volume with a representation stating that SS&C understands that in offering its ETC services and matching services it will be defined as an “SCI entity” under Regulation Systems, Compliance, and Integrity (“Regulation SCI”) and, as such, that it will operate in compliance with applicable obligations under Regulation SCI. See *infra* Part III.B.8.

<sup>5</sup> The Commission understands that the applicants included descriptions of their ETC services in their applications for the sake of completeness in describing their proposed services, as well as in connection with FINRA Rule 11860, which contains specific references to confirmation and affirmation services.

<sup>6</sup> See Exchange Act Release No. 34-74794 (Apr. 23, 2015), 80 FR 23618 (Apr. 28, 2015) (“SS&C notice”).

<sup>7</sup> See letters from James Wallin, Senior Vice President – Fixed Income, AllianceBernstein (Apr. 9, 2015) (“AllianceBernstein”); Diane C. Altieri, White Oak Global Advisors, LLC (Mar. 24, 2015) (“Altieri”); Jon Ambos (Mar. 29, 2015) (“Ambos”); Anonymous (Mar. 16, 2015) (“Anonymous”); Benjamin Macdonald, President, Bloomberg STP LLC (August 26, 2015) (“BSTP August letter”); Ben Macdonald, President, Bloomberg STP LLC (May 21, 2015) (“BSTP May letter”); M. Subramanian, Capital Market Solutions – Wipro Limited (Mar. 26, 2015) (“Capital Market Solutions”); Thomas Murphy, Managing Director, Citigroup Global Markets Inc., and Automated Trading Desk Financial Services, LLC (Apr. 6, 2015) (“Citi”); James Connolly, Managing Director, Head of U.S. Broker Dealer Operations, RBC Capital

letters and the details and information in the BSTP and SS&C applications (including their representations), the Commission concludes that it has sufficient information to decide whether BSTP and SS&C should be granted exemptions. This order grants BSTP and SS&C each an exemption from registration as a clearing agency to provide matching and ETC services, subject to certain conditions and limitations described below.

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Markets, LLC (Mar. 16, 2015) (“Connolly”); Joseph Denci, Vice President COO, Scotia Capital (USA) Inc. (Mar. 31, 2015) (“Denci”); Larry E. Thompson, Vice Chairman and General Counsel, The Depository Trust & Clearing Corporation (Sept. 14, 2015) (“DTCC September letter”); Larry E. Thompson, Vice Chairman and General Counsel, The Depository Trust & Clearing Corporation (June 23, 2015) (“DTCC June letter”); Larry E. Thompson, Vice Chairman and General Counsel, The Depository Trust and Clearing Corporation (May 28, 2015) (“DTCC May letter”); Larry E. Thompson, Vice Chairman and General Counsel, The Depository Trust & Clearing Corporation (Apr. 6, 2015) (“DTCC April letter”); Frank D. Dore, Head of Securities Operations, Acadian Asset Management LLC (Apr. 1, 2015) (“Dore”); Peter J. Durant (Mar. 26, 2015) (“Durant”); David Pearson, Head of Post-Trade Strategy, Fidessa (Apr. 3, 2015) (“Fidessa”); Bruce James, Managing Director and Chief Operations Officer, Amherst Pierpont Securities LLC (Mar. 10, 2015) (“James”); James Lang, Managing Director, Cedar Hill Capital Partners (Mar. 26, 2015) (“Lang”); Jerome Matthews, Vice President, Investment Operations, Prudential Fixed Income (Apr. 6, 2015) (“Matthews”); Shawn McCafferty (Mar. 11, 2015) (“McCafferty”); Barbara Naratil, COO (Mar. 31 and Apr. 6, 2015) (“Naratil”); Russell H. Stamey, Senior Vice President, The Northern Trust Co. (Apr. 6, 2015) (“Northern Trust”); Paul Puskuldjian, Chief Operating Officer, Kinetix Trading Solutions, Inc. (Mar. 11, 2015) (“Puskuldjian”); Terrence J. Ransford, Senior Vice President, Northern Trust Securities, Inc. (Mar. 18, 2015) (“Ransford”); Fredrick Scuteri, Vice President, Head of Trade Operations, AQR Capital Management, LLC (Mar. 16, 2015) (“Scuteri”); Timothy W. Cameron, Managing Director, Asset Management Group – Head, and Elisa Nuottajarvi, Asset Management Group, The Asset Managers Forum, Securities Industry and Financial Markets Association (Apr. 2, 2015) (“SIFMA AMF”); David I. Goldstein, Senior Counsel, SS&C Technologies, Inc. (July 20, 2015) (“SS&C letter”); Nick Solinger, Head of Product Strategy and Chief Marketing Officer, Traiana, Inc. (Apr. 6, 2015) (“Traiana”). Copies of the comment letters are available at <http://www.sec.gov/comments/600-33/600-33.shtml> and <http://www.sec.gov/comments/600-34/600-34.shtml>.

## II. Summary of Applicants' Organization and Proposed Services

### A. BSTP

BSTP is a limited liability company organized under the laws of the State of Delaware and is wholly-owned by Bloomberg L.P. ("BLP").<sup>8</sup> BLP is a global business and financial information and news company headquartered in New York with offices around the world. BLP's principal product is the BLOOMBERG PROFESSIONAL service, which provides financial market information, data, news and analytics to banks, broker-dealers, institutional investors, governmental bodies, and other business and financial professionals worldwide.

The BSTP application states that BSTP will enter into a Software License Agreement and a License and Services Agreement with BLP. Under the terms and conditions of such agreements, BLP will provide BSTP with software, hardware, administrative, operational, and other support services, and BSTP will retain ultimate legal responsibility for its operations. BSTP has also established a board of directors to oversee its operations, and the BSTP application states that it will establish an advisory board consisting of industry members and users of the matching service, including representatives from sell-side firms, buy-side institutions, and custodians.

The BSTP application proposes a matching service that will compare post-trade information from a broker-dealer (the firm) and the broker-dealer's institutional customer and reconcile such information to generate an affirmed confirmation, operating as follows according to the BSTP application:

1. A customer routes an order to its firm.

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<sup>8</sup> The Commission notes that any proposed changes to either applicant's organization or its proposed ETC and matching service will require an amendment to the applicant's Form CA-1.

2. The firm executes the order and then sends a notice of execution (“NOE”) to the customer.
3. For voice executed trades, the customer affirms to the firm the trade details contained in the NOE. For trades executed electronically, the electronic trading platform records the trade in the blotters of the customer and the firm.
4. The customer sends to the matching service, the firm, and the customer’s custodian allocation information for the trade.
5. The firm then submits to the matching service trade data corresponding to each allocation, including settlement instructions and, as applicable, commissions, taxes, and fees.
6. The matching service next compares the customer’s allocation information (containing multiple fields of data) with the firm’s trade data to determine whether the information contained in each field matches. If all required fields match, the matching service generates a matched confirmation and sends it to the firm, the customer, and other entities designated by the customer (e.g., the customer’s custodian). The matching service will typically perform this step in less than one second.
7. After the matching service creates the matched confirmation, the matching service submits it to The Depository Trust Company (“DTC”) as an “affirmed confirmation.” From there, the trade goes into DTC’s settlement process.

Other than the matching service, the BSTP application states that BSTP will not perform any other functions of a clearing agency requiring registration under Section 17A of the

Exchange Act, such as net settlement, maintaining a balance of open positions between buyers and sellers, marking securities to the market, or handling funds or securities.

B. SS&C

SS&C was incorporated in Delaware in 1996 and has headquarters in Windsor, Connecticut, with offices in 20 locations across the United States and additional offices in Toronto, Canada, and other locations throughout the world. SS&C is a global provider of financial services-related solutions to investment management, banking, and other financial sector clients. All control and direction over SS&C is vested in SS&C Technologies Holdings, Inc. ("SS&C Holdings"), SS&C's parent company and a public holding company listed on NASDAQ (symbol SSNC).

The SS&C application states that all matching services would be performed by SS&C's subsidiary, SS&C Technologies Canada Corp. ("SS&C Canada"). The policies and operations of SS&C Canada are overseen by its officers and directors, and are subject to control by SS&C Holdings. SS&C Canada will perform the matching services in Mississauga, Canada, through its software-enabled service, SSCNet, which is a global trade network linking investment managers, broker-dealers, clearing agencies, custodians, and interested parties. Client support for these services will be rendered through SS&C's offices in the United States, the United Kingdom, and Australia. SS&C will coordinate support activity, which includes help desk facilities and call and issue tracking through a shared client call database, and relationship management. SS&C and SS&C Canada will maintain an intercompany agreement setting forth respective services and obligations.

In addition, the SS&C application makes the following representations regarding SS&C's operations: (i) SS&C shall obtain contractual commitments from its customers permitting it to

provide information to the Ontario Securities Commission, the Commission, and other third parties; (ii) SS&C shall make available SS&C Canada employees in Canada or the United States for interview by the Commission subject to reasonable notice, provided that such action does not impose unreasonable hardship under applicable immigration law on such employees; (iii) as set forth in the intercompany agreement, SS&C shall provide the Commission access to information related to SS&C's matching system and ETC services, including those documents it receives from its service provider, SS&C Canada (the "business activities information"); (iv) SS&C Canada shall provide on the same business day to SS&C at its headquarters in Windsor, Connecticut electronically generated business activities information, in whatever form SS&C shall specify, including regularly and automatically generated and ad hoc reports, books and records, correspondence, memoranda, papers, notices, accounts, and other such records; and (v) SS&C Canada shall send to SS&C at its headquarters in Windsor, Connecticut, all manually generated business activities information, in whatever form SS&C shall specify, no later than the business day on which the record is generated. Further, SS&C has confirmed with external counsel that implementation of the intercompany agreement would not violate the Canadian Personal Information Protection and Electronic Documents Act or the Ontario Business Records Protection Act.<sup>9</sup> This would allow for the disclosure of personal information by SS&C Canada to SS&C.

Like the BSTP application, the SS&C application proposes to provide matching and ETC services for broker-dealers and institutional customers that will allow such entities to streamline

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<sup>9</sup> SS&C has stated that as the draft intercompany agreement is governed by Connecticut law, and as SS&C's external counsel are not qualified to practice in Connecticut, in providing these opinions they have assumed that the provisions of the intercompany agreement have the same meaning under Connecticut law as they would under Ontario and Canadian law.

communications and process allocation and post-trade information for fixed-income and equity trades for depository-eligible U.S. securities. According to the SS&C application, SS&C's matching service would allow institutional customers to route an order to a broker, receive an execution notice from the broker, and enter trade details and allocations so that SS&C's matching service can generate a matched confirmation and send an affirmed confirmation to the depository at DTC. SS&C's matching service will offer both block level matching and detail level matching. Standing settlement instructions are provided through the Delivery Instruction Database, which is fully integrated into SSCNet, and provides a repository for settlement instructions across asset classes, including foreign exchange and term deposits. SSCNet is also integrated into the Society for Worldwide Interbank Financial Telecommunication ("SWIFT") Network, allowing users to communicate with parties outside the SSCNet platform. Users can select the output format for batch communications (SSCNet proprietary, SWIFT, ISITC, or DTC affirmation format), as well as when the batch should be submitted. Once a transaction is exported from SSCNet, central time stamping and a full audit trail are available for all transactions, with transaction histories maintained online for a minimum of 45 days and accessible in an online archive for up to ten years.

Other than the matching service, the SS&C application states that SS&C will not perform any other functions of a clearing agency requiring registration under Section 17A of the Exchange Act, such as net settlement, maintaining a balance of open positions between buyers and sellers, marking securities to the market, or handling funds or securities.

### III. Discussion

#### A. Statutory Standards

##### 1. Requirements for a National System for Clearance and Settlement

Section 17A of the Exchange Act directs the Commission to facilitate the establishment of (i) a national system for the prompt and accurate clearance and settlement of securities transactions and (ii) linked or coordinated facilities for clearance and settlement of securities transactions.<sup>10</sup> In facilitating the establishment of the national clearance and settlement system, the Commission must have due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents.<sup>11</sup>

##### 2. Standard for Approval of an Application for an Exemption from Registration as a Clearing Agency

Section 17A(b)(1) of the Exchange Act requires all clearing agencies to register with the Commission.<sup>12</sup> It also states that, upon the Commission's motion or upon a clearing agency's application, the Commission may conditionally or unconditionally exempt a clearing agency from any provision of Section 17A of the Exchange Act or the rules or regulations thereunder if the Commission finds that such exemption is consistent with the public interest, the protection of investors, and the purposes of Section 17A, including the prompt and accurate clearance and settlement of securities and funds.

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<sup>10</sup> See 15 U.S.C. 78q-1(a)(2)(A).

<sup>11</sup> See id.

<sup>12</sup> See 15 U.S.C. 78q-1(b)(1).

In the Matching Release,<sup>13</sup> the Commission concluded that an entity providing matching services as an intermediary between broker-dealers and institutional customers is a clearing agency within the meaning of Section 3(a)(23) of the Exchange Act,<sup>14</sup> and therefore subject to the registration requirements of Section 17A of the Exchange Act.<sup>15</sup> The Commission also noted that an entity that limited its clearing agency functions to providing matching services might not have to be subject to the full range of clearing agency regulation. In addition, the Commission stated that it anticipated an entity seeking an exemption from clearing agency registration for matching services would be required to (i) provide the Commission with information on its matching service and notice of material changes to its matching service; (ii) establish an electronic link to a registered clearing agency that provides for the settlement of its matched trades; (iii) allow the Commission to inspect its facilities and records; and (iv) make periodic disclosures to the Commission regarding its operations.<sup>16</sup> Accordingly, as noted in the Matching

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<sup>13</sup> See Exchange Act Release No. 34-39829 (Apr. 6, 1998), 63 FR 17943 (Apr. 13, 1998) (providing interpretive guidance and requesting comment on the confirmation and affirmation of securities trades and matching) (“Matching Release”).

<sup>14</sup> Section 3(a)(23) defines a “clearing agency” as, among other things:

[A]ny person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who provides facilities for comparison of data respecting the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities.

See 15 U.S.C. 78c(a)(23).

<sup>15</sup> Specifically, the Commission concluded that matching services constitute comparison of data respecting the terms of settlement of securities transactions. See Matching Release, *supra* note 13, at 17943.

<sup>16</sup> See *id.* at 17947 n.28. In addition, the Commission provided a temporary exemption from the clearing agency registration requirements to clearing agencies that provide (1)

Release, a clearing agency whose clearing agency functions are limited to providing a matching service generally would be required to register as a clearing agency but could apply for an appropriate exemption.<sup>17</sup>

B. Comments Received and Commission Response

The Commission received thirty comment letters in response to the BSTP and SS&C notices from twenty-three commenters, including two comment letters from BSTP and one from SS&C.<sup>18</sup> Although the Commission received only three comment letters on the SS&C application, the comments received in response to both applications are discussed together below because the matching services proposed in each application are substantially similar and therefore raise many of the same issues regardless of which application a particular comment letter addresses. In addition, a majority of the comments submitted in response to the BSTP application address the question of whether there should be multiple providers of matching services, and those comments are therefore relevant to the Commission's consideration of both the BSTP and SS&C applications.

Commenters include individuals and firms representing buy-side and sell-side market participants, in both front and back-office capacities, with expertise in equities and fixed income, asset management, post-trade strategy, and operations. Four of the comment letters were

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matching, (2) trade compression, (3) collateral management, and (4) other non-central counterparty clearance and settlement services for security-based swaps. See Exchange Act Release No. 34-64796 (July 1, 2011), 76 FR 39963 (July 7, 2011) (order pursuant to Section 36 of the Exchange Act granting temporary exemptions from clearing agency registration requirements under Section 17A(b) of the Exchange Act for entities providing certain clearing services for security-based swaps).

<sup>17</sup> See Matching Release, supra note 13, at 17947.

<sup>18</sup> See supra note 7.

submitted by the Depository Trust and Clearing Corporation (“DTCC”),<sup>19</sup> which is the holding company for three clearing agencies registered with the Commission, including DTC (the central securities depository (“CSD”) for the U.S. securities markets), as well as Omgeo, an exempt clearing agency that currently provides matching and ETC services for the U.S. equity markets (collectively “the DTCC complex”).<sup>20</sup> Excluding BSTP and SS&C, eighteen commenters expressed explicit support for the BSTP application and three additional commenters submitted comments on the BSTP application expressing support for competition in the provision of matching services.<sup>21</sup> One commenter expressed views that it would support additional providers of matching and ETC services if they met certain criteria.<sup>22</sup> The remaining commenter, DTCC, endorsed the approach described in the Matching Release, stating that (i) a firm limiting its

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<sup>19</sup> The DTCC June letter also includes as an attachment an economic analysis of BSTP’s application produced by Cornerstone Research. See DTCC June Letter at ex. I, available at <http://www.sec.gov/comments/600-33/60033-28.pdf> (“Cornerstone Report”). The Cornerstone Report augments many of the comments in the DTCC comment letters with several specific economic considerations that are related to those arguments. These comments and considerations are addressed throughout this order.

<sup>20</sup> The other two registered clearing agencies within the DTCC complex are (i) the National Securities Clearing Corporation (“NSCC”), which provides central counterparty (“CCP”) services to its members for the clearing of transactions in a number of cash market products, including equity securities, bonds, and exchange-traded products, and (ii) the Fixed Income Clearing Corporation (“FICC”), which provides CCP services for transactions in U.S. government and certain mortgage-backed securities.

<sup>21</sup> For commenters expressing explicit support for the BSTP application, see AllianceBernstein, Altieri, Anonymous, Capital Market Solutions, Connolly, Denci, Dore, Fidessa, James, Lang, Matthews, McCafferty, Northern Trust, Puskuldjian, Ransford, Scuteri, SIFMA AMF, and Traiana.

For commenters to the BSTP application expressing support more generally for competition in the provision of matching services, see Ambos, Durant, and Naratil.

<sup>22</sup> See Citi; see also *infra* note 137 and accompanying text (discussing the specific criteria set forth by the commenter).

clearing agency activities to matching services should be eligible for an exemption from registration as a clearing agency and (ii) this is consistent with the goals of Section 17A of the Exchange Act, expressed general support for competition in the provision of matching services,<sup>23</sup> and raised several concerns with the BSTP and SS&C applications, as discussed below. In addition, in its letter, SS&C states that it is in complete agreement with BSTP on matters where DTCC's concerns are substantially the same between the BSTP and SS&C applications, such as DTCC's concerns raised regarding the question of how access to DTC for settlement of matched trades should proceed.<sup>24</sup> Similarly, DTCC states that it stands by its statements and positions in the DTCC June letter, submitted in response to the BSTP May letter, and incorporates those arguments by reference in response to the SS&C letter.<sup>25</sup>

The discussion below first summarizes DTCC's proposed model for access to DTC submitted as part of its comments regarding the BSTP and SS&C applications. The discussion

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<sup>23</sup> See DTCC April letter at 1–2 (endorsing the approach described in the Matching Release); DTCC September Letter at 2; DTCC June letter at 2–3; DTCC May letter at 2–3; DTCC April letter at 2, 12–14 (each stating that competition in service offerings may permit useful innovation and product alternatives, to the benefit of industry participants and ultimately to investors, and proposing a method of facilitating access to DTC through Omgeo for BSTP and SS&C).

<sup>24</sup> See SS&C letter at 4. Accordingly, as to DTCC's comments, the Commission understands that SS&C would be in agreement with BSTP as to concerns about access to DTC and the related discussions of efficiency; competition, choice, and innovation; systemic risk; operational risk; and interoperability with Omgeo. Concerns raised about BSTP's governance arrangements and BSTP's request for relief under Rule 10b-10 would be specific to BSTP. Concerns raised about the cross-border aspects of the SS&C application would be specific to SS&C.

<sup>25</sup> See DTCC September letter at 2 n.5. In considering and addressing DTCC's comments, the Commission has considered each application with respect to all of DTCC's comments except where DTCC's comments were addressed specifically to BSTP's governance arrangements, BSTP's request for relief under Rule 10b-10, and the cross-border aspects of the SS&C application, as noted previously above. See *supra* note 24.

next provides an overview of comments organized by the particular subject matter raised across the respective comment files, and provides BSTP's and SS&C's responses as well as the Commission's assessment and response within each subject matter section. The Commission notes here that many of DTCC's current arguments are inconsistent with prior representations it made when it sought for Omgeo—and Omgeo was granted, based on those representations—an exemption from registration to provide matching services. Those representations are discussed in detail below.

1. DTCC's Proposed Model for Access to DTC

In order to evaluate many of the particular issues raised by the commenters, the Commission first generally notes DTCC's proposal for structuring access to DTC, which is referenced throughout the Commission's consideration of comments below. According to DTCC, the optimal access model, referred to below as the "single access" model, would enable the industry to continue to rely on the existing systems (including certain systems currently located in Omgeo) to serve as the unique point of access to what DTCC describes as "the existing infrastructure," in particular DTC and the bank and broker-dealer custodians/settlement agents for the sending of matching confirmations and settlement instructions.<sup>26</sup> In other words, a single access model would require BSTP and SS&C to access this existing infrastructure uniquely through Omgeo and not via independent linkages to DTC.

DTCC believes that this approach would promote the safe and efficient clearance and settlement of securities transactions while permitting the securities industry to reap the benefits

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<sup>26</sup> See DTCC September letter at 2; DTCC June letter at 2-3; DTCC May letter at 2; DTCC April letter at 3.

of the reliable, centralized infrastructure that has developed over the past forty years.<sup>27</sup> DTCC states that the single access model would permit BSTP and SS&C to avail themselves of Omgeo's extensive community of custodians and settlement agents without the costs and risks that would be incurred if each custodian and settlement agent had to create, operate, and maintain a separate interface and infrastructure with BSTP and SS&C.<sup>28</sup> DTCC also notes that this would provide a more rapid, less expensive option for BSTP and SS&C to begin providing matching services.<sup>29</sup> DTCC states that the single access model furthers the purposes of Section 17A of the Exchange Act, citing previous Commission statements that (i) a clearing agency entering into an interface with another clearing agency has an interest in assuring itself that the participant clearing agency will be able to meet its obligations, and that (ii) clearing agencies may require reasonable assurances of another clearing agency's ability to meet its obligations, provided such requirement does not impose an inappropriate burden on competition.<sup>30</sup>

The Commission evaluates the merits of the BSTP and SS&C applications on their own terms under the statutory standard described above. The Commission is not opining on the general issue of whether a multiple access model is always preferable to a single access model.

## 2. Efficiency

Under Section 17A of the Exchange Act, Congress directs the Commission to facilitate a prompt system for clearing and settling transactions, and the Congressional findings in Section

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<sup>27</sup> See id.

<sup>28</sup> See DTCC April letter at 12–13.

<sup>29</sup> See id.

<sup>30</sup> See DTCC September letter at 2; DTCC May letter at 8–9.

17A state that inefficient procedures for clearance and settlement impose unnecessary costs on investors and persons facilitating transactions.

The Commission received multiple comments addressing whether the expected effect of the BSTP and SS&C applications would result in various inefficiencies, with a particular focus on the possibility of unnecessary costs and processing inefficiencies. BSTP states in its comment letter that the BSTP application promotes processing efficiencies by proposing to bring automation to some segments of the marketplace that today use manual procedures and by enabling straight-through processing throughout the entire trade lifecycle, which BSTP states will contribute to increases in same-day affirmation rates and increases in settlement rates.<sup>31</sup> Similarly, SS&C states in its comment letter that the SS&C application promotes processing efficiencies by streamlining the post-trade communication flow between institutional customers, broker-dealers, custodians, and interested parties, providing for real-time communications and matching services that highlight trade discrepancies early in the trade lifecycle, which SS&C states will lead to timely affirmations and a reduction in failed deliveries.<sup>32</sup> In addition, nine commenters identified increases in efficiency in the confirmation/affirmation process itself as an anticipated benefit of having multiple matching service providers.<sup>33</sup>

However, DTCC raises multiple concerns, summarized below, about the effect of the applications on the efficiency (both in terms of unnecessary costs and processing inefficiencies) of the settlement system for U.S. equities. The Commission understands that DTCC is primarily

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<sup>31</sup> See BSTP May letter at 3.

<sup>32</sup> See SS&C letter at 2.

<sup>33</sup> See AllianceBernstein at 1; Altieri; Capital Market Solutions; Connolly; James; Lang; Northern Trust; SIFMA AMF at 2; Traiana.

concerned with the following matters: (i) whether it is efficient for BSTP and SS&C to have direct access (rather than mediated access) to DTC for submission of delivery orders; (ii) whether new matching service providers might negatively affect current trade confirmation/affirmation rates; (iii) how control numbers for trades can be managed efficiently in a marketplace with multiple matching service providers; and (iv) whether the costs that DTCC and market participants might incur to incorporate new matching service providers into the market infrastructure can be supported by the anticipated benefits. The Commission evaluates each of these concerns in turn.

i. Access to DTC

With respect to the access model proposed by each of the BSTP and SS&C applications, DTCC states that allowing both BSTP and SS&C to access DTC directly under a “multiple access” model would impose additional costs on the industry, including the cost of building access to DTC for each applicant and the related cost of building parallel access to custodians and settlement agents.<sup>34</sup> In addition, DTCC also states that developing a post-trade processing system, including a settlement instructions database, that is completely independent of Omgeo (including the Omgeo ALERT database that centrally maintains account information and standing settlement instructions to enrich allocation messages for settlement at DTC) would raise interface costs for industry participants and increase the technological complexity of the infrastructure for the national clearance and settlement system.<sup>35</sup> DTCC also notes that failed

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<sup>34</sup> See DTCC April letter at 11; Cornerstone Report at 6, 23.

<sup>35</sup> See id. at 17–19. The Commission notes that DTCC’s concerns about the costs of building linkages are addressed in Part III.B.2.iv below.

trades are currently resolved and reconciled through Omgeo, not DTC.<sup>36</sup> As an alternative to a multiple access model, DTCC proposed a single access model, summarized above in Part III.B.1.

DTCC's current arguments supporting a single access model that runs through Omgeo cannot be reconciled with DTCC's own prior representations surrounding the formation of the joint venture between DTCC and Thomson Financial (Global Joint Venture or "GJV," later renamed Omgeo), which was granted an exemption from registration to provide matching services in the Omgeo order.<sup>37</sup> The Commission finds that DTCC must continue to abide by prior representations it made that led the Commission to approve the Omgeo order.

For purposes of background, as a condition precedent to the GJV's formation, DTC submitted a proposed rule change to transfer DTC's existing ETC and matching engine to Omgeo as its contribution to the GJV.<sup>38</sup> The Commission received thirty-six comment letters in response to both the DTC 00-10 proposal and the notice that preceded the Omgeo order,

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<sup>36</sup> See *id.* at 14 n.43.

<sup>37</sup> See Global Joint Venture Matching Services—US, LLC; Order Granting Exemption From Registration as a Clearing Agency, Exchange Act Release No. 34-44188 (Apr. 17, 2001), 66 FR 20494 (Apr. 23, 2001) ("Omgeo order").

<sup>38</sup> See Exchange Act Release No. 34-43541 (Nov. 9, 2000), 65 FR 69591 (Nov. 17, 2000) (notice of filing by DTC of a proposed rule change relating to the combination of the DTC's TradeSuite institutional trade processing services with Thomson-Financial ESG's institutional trade processing services) ("DTC 00-10 proposal"); see also Exchange Act Release No. 34-44189 (Apr. 17, 2001), 66 FR 20502 (Apr. 23, 2001) (Commission order approving DTC's proposed rule change relating to the combination of DTC's TradeSuite institutional trade processing services with Thomson-Financial ESG's institutional trade processing services) ("DTC 00-10 approval order").

In the above proposed rule change, the transfer involved TradeMessage (automated exchange of messages such as block trade notices of execution, allocation instructions, trade confirmations, and affirmations), TradeMatch (electronic comparison of investment manager allocations with broker-dealer trade confirmations), TradeSettle (supplier of account and settlement data using DTC's Standing Instructions Database, and router of settlement instructions to custodian banks and clearing agents), and TradeHub (router of messages).

seventeen of which requested that the Commission take steps to safeguard interoperability and competition among service providers in order to prevent any entity from gaining an unfair monopoly.<sup>39</sup>

The Commission believes that providing a summary of key comments on the DTC 00-10 proposal is helpful in explaining the Commission's assessment of DTCC's objections to the BSTP and SS&C applications because the past comments raise many of the same issues raised in the comments to this order. One of the commenters cited by the Commission in the DTC 00-10 approval order, TradingLinx, focused its concern on the transfer of TradeMessage and TradeSettle,<sup>40</sup> which was notable given that the Commission was primarily focused on the transfer of the matching service functionality. The TradingLinx letter pointed out that, at the time, all vendors had free, open access to the data contained in DTC's Standing Instructions Database ("SID"), which houses settlement instructions for the industry. TradingLinx worried that transferring SID to a for-profit entity might change the cost or level of access to SID data. DTCC submitted a comment in response, stating that TradingLinx's concerns were misplaced because (i) vendors acting on behalf of DTC participants will be able to transmit settlement instructions directly to DTC without the involvement of GJV; (ii) vendors acting on behalf of customers of the DTC TradeSuite family of services have access to SID; (iii) those vendors can enter data in and receive data from SID on behalf of broker-dealers, investment managers, and custodians who are common customers of the vendors and DTC; and (iv) the staffs of DTCC and

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<sup>39</sup> See Omgeo order, supra note 37, at 20504.

<sup>40</sup> See letter from Justin Lowe, Chief Executive Officer, and Robert Raich, Chief Financial Officer, TLX Trading Network (Dec. 18, 2000), available at <http://www.sec.gov/rules/sro/60032/60032-13.pdf>.

GJV have determined that the same open access by customers' vendors to SID will continue with respect to the unified database after GJV commences operations.<sup>41</sup>

Another commenter on the DTC 00-10 proposal, GSTP AG, expressed concerns that combining elements of DTC with a commercial entity could result in denial of access to DTC for matching service competitors, and/or pricing for access to DTC settlement and depository services that might preference GJV over matching service competitors.<sup>42</sup> DTCC responded by reiterating the assurances it made in its response to TradingLinx, stating that GJV will at the option of its customers either enter settlement instructions on their behalf into the DTC settlement system (or any other settlement system with which the GJV interfaces) or make the settlement instructions available to the customers or their vendors so that the customers or vendors can enter the instructions into a settlement system.<sup>43</sup> GSTP AG then responded with requests (also cited by the Commission in the Omgeo order) that, before these issues can be resolved, it be clearly understood which functions will continue to be performed exclusively by DTC and which will be performed by the GJV, noting that (i) DTC offers through TradeSuite a service to all U.S. settlement agents who have an account with DTC for settlement whereby the trades confirmed and/or affirmed are relayed to the settlement agent involved in the trade; (ii) this feature of the service is an integral part of the clearance and settlement process as it is used

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<sup>41</sup> See letter from Carl H. Urist, Managing Director and Deputy General Counsel, DTCC (Jan. 4, 2001), available at <http://www.sec.gov/rules/sro/60032/60032-18.pdf>.

<sup>42</sup> See letter from Burkhard H. Gutzeit, Chairman, and G. Steven Crosby, Acting Chief Executive Officer, GSTP AG (Jan. 3, 2001), available at <http://www.sec.gov/rules/sro/60032/60032-16.pdf>.

<sup>43</sup> See letter from Carl H. Urist, Managing Director and Deputy General Counsel, DTCC (Jan. 12, 2001), available at <http://www.sec.gov/rules/sro/60032/60032-24.pdf>.

by all settlement agents to update their records and by the DTC to proceed with the settlement; and (iii) fair and open access to DTC settlement functions for all matching services must encompass a requirement that DTC, and not the GJV, continue to provide this service.<sup>44</sup>

DTCC's subsequent response indicated that DTC would limit its activities to following the settlement instructions authorized by its participants, whether those instructions were submitted by GJV or GSTP AG.<sup>45</sup> The Commission ultimately approved the DTC-00-10 proposal after DTC submitted an amendment to the rule filing stating that DTC shall not favor any single provider of matching services, including GJV, over any other matching services in terms of the quality and caliber of the interface to DTC's clearing agency or settlement functions, quality of connectivity, receipt of delivery and payment orders, speed or processing delivery and payment orders, capacity provided, or priority assigned in processing delivery and payment orders.<sup>46</sup>

Subsequent to approval of the Omgeo order, DTC also submitted proposed rule change SR-DTC-2001-11, proposing to authorize DTC to accept and act upon instructions provided by a central matching provider other than Omgeo. The Commission's approval order discussed two significant factors relevant to DTCC's comments regarding access to DTC.<sup>47</sup> First, the approval

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<sup>44</sup> See letter from Burkhard H. Gutzeit, Chairman, and G. Steven Crosby, Acting Chief Executive Officer, GSTP AG (Jan. 30, 2001), available at <http://www.sec.gov/rules/sro/60032/60032-33.pdf>.

<sup>45</sup> See letter from Richard B. Nesson, Managing Director and General Counsel, DTCC (Mar. 9, 2001), available at <http://www.sec.gov/rules/sro/60032/60032-38.pdf>.

<sup>46</sup> See DTC 00-10 approval, *supra* note 38, at 20505.

<sup>47</sup> See Exchange Act Release No. 34-44905 (Oct. 4, 2001), 66 FR 51987 (Oct. 11, 2001) (order approving DTC rule change authorizing DTC to act upon instructions provided by a central matching service provider).

order noted that DTC neither engaged in matching institutional trade information nor communicated to its participants or others prior to settlement that a transaction has been matched.<sup>48</sup> Pursuant to the order, then, DTC and Omgeo had clear and distinct functions: Omgeo was to provide matching services and DTC was to facilitate settlement. Second, the approval order noted that (i) DTC assumed a matching service provider would make arrangements for the communication of trade information to the DTC participants expected to settle a matching transaction by book-entry delivery at DTC, and (ii) DTC was prepared to accept from a matching service provider a file of deliver order instructions to settle transactions between DTC participants that had authorized it to accept such instructions from the matching service provider.<sup>49</sup>

In approving the proposed rule change, the Commission stated its belief that the DTC rule change was consistent with the Exchange Act because it would allow DTC to act upon deliver order instructions received from a matching service provider.<sup>50</sup> The Commission observes that this is precisely the arrangement now contemplated by the BSTP and SS&C applications—one where BSTP and SS&C, as matching service providers, can communicate settlement instructions to DTC without Omgeo as an intermediary. Given the series of representations made by DTCC in support of approving the DTC rule changes that facilitated the creation of Omgeo and approval of the Omgeo order itself, the Commission views DTCC's

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<sup>48</sup> See id. at 51987.

<sup>49</sup> See id. at 51987–88.

<sup>50</sup> See id. at 51988.

current suggestion that the Commission now require a single access model for new matching service providers to be inconsistent with DTCC's prior representations.

Even apart from DTCC's prior inconsistent representations, the Commission is also unpersuaded that the prospect of incurred costs merits denial or modification of the applications insofar as they propose a multiple access model. Matching service providers cannot settle transactions since they necessarily require access to the central securities depository for the United States, and as such access to the central securities depository is distinct from access to other post-trade processes (such as providing a standing instructions database).<sup>51</sup> The Commission further believes that multiple points of access to DTC have value with respect to redundancy (discussed further below). The Commission also finds that DTCC's objections to costs generated by multiple points of access—which the Cornerstone Report did not estimate—are speculative.<sup>52</sup> Moreover, these types of costs should not be unexpected in light of the Omgeo order, as described in more detail below. Further, if the Commission were to require each matching service provider to access DTC through Omgeo, such dependency could allow Omgeo to impose surcharges or other costs on its competitors that are not imposed on Omgeo itself, which the Commission believes could lead to unnecessary costs. Even if no fees were imposed, the structure could also limit innovation in the provision of matching services by other matching service providers. BSTP and SS&C also cautioned against such an outcome. BSTP describes in its comment letter that any new matching service provider required to rely on Omgeo would find

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<sup>51</sup> As noted above, SS&C has its own Delivery Instruction Database. See supra Part II.B (describing SS&C's proposed service).

<sup>52</sup> See, e.g., Cornerstone Report at 30 (stating that there are aspects of central matching services that may be best provided by a single provider).

itself in the untenable position of being dependent on a competitor's infrastructure, cooperation, and fee structure to operate its business and would likely find that such circumstances create an insurmountable barrier to entry.<sup>53</sup> Similarly, SS&C infers from DTCC's position that Omgeo would impose the same charges on competing matching services as they do on clients today and states that, should the Commission accept this position, SS&C doubts that any service would find it economically viable to enter the market for post-trade services to compete with Omgeo.<sup>54</sup>

The Commission notes that the BSTP and SS&C applications did not specify whether BSTP or SS&C planned to develop their own duplicate standing instructions database. In cases where BSTP and SS&C can choose whether to depend on an existing system or develop their own, the Commission expects that market forces will determine whether utilizing existing services or systems will be dictated by an assessment of the business costs and benefits related to such choices. The Commission believes that such decisions are not predetermined.

Finally, the Commission notes that DTCC has adopted a multiple access model for trade data submitted to one of its other registered clearing agencies, NSCC. Currently, NSCC receives trade data directly from exchanges, qualified special representatives, correspondent clearing agencies, and Omgeo.<sup>55</sup> Because trade information is coming from separate market participants directly into NSCC, the Commission believes that this example further suggests that a DTCC

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<sup>53</sup> See BSTP August letter at 4.

<sup>54</sup> See SS&C letter at 3.

<sup>55</sup> See generally NSCC & Industry Working Group, Trade Clearance Input Concept Paper (August 2014), available at <http://www.dtcc.com/news/2014/september/16/dtcc-publishes-concept-paper-on-trade-clearance-input> (discussing NSCC's system for capturing trades).

registered clearing agency can receive data directly from Omgeo and multiple other entities in an effective and efficient manner that is consistent with the Exchange Act.<sup>56</sup>

ii. Effect on Trade Confirmation/Affirmation Rates and Industry Efforts to Shorten the Settlement Cycle

DTCC states that the multiple access model contemplated by the BSTP and SS&C applications may decrease the promptness of the current matching services infrastructure by increasing the time necessary to route confirmations and affirmations between customers and service providers.<sup>57</sup> In the Cornerstone Report, DTCC cites research suggesting that certain components of the market's infrastructure, which may include the national system for clearance and settlement, have characteristics where the optimal structure is to provide clearing and settlement services via a single, regulated entity rather than multiple competing firms.<sup>58</sup> DTCC states that broker-dealers using multiple matching services would be required to either modify existing systems to account for multiple matching service providers or invest in multiple

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<sup>56</sup> The history of ETC services reflects a similar multiple access approach. To facilitate settlement in a registered securities depository following use of an ETC service, DTC coordinated with the Midwest Securities Trust Company ("MSTC") and the Philadelphia Depository Trust Company ("Philadep") to ensure that DTC participants on one side and sole participants in either MSTC or Philadep on the other side could collectively achieve ETC by linking DTC's automated settlement system for institutional transactions with similar systems developed in coordination with MSTC and Philadep. See Exchange Act Release No. 34-19227 (Nov. 9, 1982), 47 FR 51658, 51659-60 (Nov. 16, 1982). The Commission noted that these linked systems facilitated communications without regard to the parties' choice of depository, thereby promoting uniformity in clearance and settlement procedures. The Commission also noted at the time that the linkages should reduce unnecessary costs associated with settlement, such as from delayed or lost affirmation and settlement instructions. See *id.* at 51660-61.

<sup>57</sup> See DTCC April letter at 13.

<sup>58</sup> See Cornerstone Report at 4, 20-21 (describing the roles that economies of scale and network effects play in the provision of clearing services). DTCC also notes, for example, that there appears to be little dispute that the core depository services currently provided by DTC are more efficiently provided by a single depository than by multiple competing depositories. See *id.* at 4.

systems, one for each such matching service provider, to obtain trade confirmations and transmit settlement instructions.<sup>59</sup> DTCC also states that this duplication in systems would likely lead to additional costs and risks of error to the detriment of industry participants and their customers, who may face additional burdens to make timely deliveries, impairing their ability to comply with Rule 10b-10 and Regulation SHO.<sup>60</sup> Further, DTCC states that BSTP's entry may induce participants to move from Omgeo's to a less efficient sequential model, which according to data from Omgeo yields significantly lower affirmation rates in the majority of DTC eligible transactions.<sup>61</sup> DTCC states that the combined effect of these potential consequences could also impair industry efforts to shorten the settlement cycle.<sup>62</sup>

After carefully considering these comments, the Commission believes that, on balance, approval of the BSTP and SS&C applications is more likely to promote rather than impair promptness in the market for matching services, particularly with respect to the effect on

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<sup>59</sup> See id. at 19; DTCC April letter at 8. This section focuses specifically on aspects of this concern related to efficiency, such as the potential need for broker-dealers to obtain trade confirmations and transmit settlement instructions using multiple systems. The costs of establishing linkages are addressed below in Part III.B.2.iv. The potential for an increase in systemic or operational risk are addressed, respectively, in Parts III.B.4 and III.B.5.

<sup>60</sup> See Cornerstone Report at 7; DTCC April letter at 8 (noting that maintaining multiple systems for compliance with Rule 10b-10 would require not only referencing two sources for providing trade instructions but also two sources for receiving, downloading, and maintaining such trade confirmations under the applicable recordkeeping rules, resulting in unnecessary duplication, additional costs, and an increased risk of errors).

BSTP requested that the Commission clarify the need for a matching service provider to obtain no-action relief under Rule 10b-10 in order to provide ETC and matching services. The Commission notes that BSTP has obtained such no-action relief from the Division of Trading and Markets. In addition, the Commission notes that SS&C obtained no-action relief from the Division of Trading and Markets in 2008.

<sup>61</sup> See Cornerstone Report at 6.

<sup>62</sup> See DTCC April letter at 16.

confirmation/affirmation rates and industry efforts to shorten the settlement cycle. First, the Commission acknowledges that obtaining access to new matching service providers may require market participants to modify existing systems or purchase new systems to facilitate access to those matching service providers. But the Commission notes that these costs would be borne only by market participants presented with new products or services that they anticipate will offer benefits not available via the existing market infrastructure or via existing matching service providers that justify bearing these costs. DTCC's concern that these systems may be duplicative ignores that duplicative services may carry benefits that market participants seek, such as providing a new access point to DTC, a new interface with features not provided by Omgeo, or access to new markets or market participants not accessible through Omgeo.

BSTP states that its matching service will receive trade execution information in real time, thereby enabling users to immediately identify and address processing exceptions on the trade date. BSTP states that it will provide a variety of efficiency tools that it believes are not currently offered to market participants to help them manage settlement exceptions, including tools for exception monitoring and instant chat functionality.<sup>63</sup> The Commission believes that streamlining the confirmation/affirmation function helps facilitate prompt settlement because, as the use of manual processes for entry of information decreases, the opportunity to improve same-day (i.e., prompt) affirmation rates for U.S. equities increases. The Commission also believes that the tools BSTP intends to offer will increase the ability of market participants and their custodians to manage settlement exceptions.

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<sup>63</sup> See BSTP application at S-3, S-5; see also BSTP May letter at 8.

Second, the Commission does not find DTCC's argument that matching services fall among those components of the market's infrastructure having characteristics where the optimal structure is to provide them via a single entity rather than multiple competing firms to be so compelling as to justify denial or modification of the applications. DTCC comments, including comments in the Cornerstone Report, fail to establish or otherwise substantiate in any specific detail how the fixed costs of operating a matching service are so high as to generate inefficiencies if borne by more than one provider.<sup>64</sup> As BSTP notes in its comment letter, the Cornerstone Report concedes that the research supporting this argument concerns providers of CSD and CCP services, not confirmation/affirmation platforms or matching services.<sup>65</sup> The Commission believes that this difference in clearing agency activity is significant and notes that the characteristics of a matching service provider are distinct from those of a clearing agency providing CSD or CCP services. The Commission's treatment of the different entities within the DTCC complex helps to illustrate this point. For instance, clearing agencies that provide CSD and CCP services, such as DTC and NSCC, are registered with the Commission, act as SROs under Section 19 of the Exchange Act, submit rule filings for Commission review and approval, and remain subject to the full set of requirements applicable to clearing agencies under Section 17A of the Exchange Act, as well as the rules and regulations thereunder. Matching service providers like Omgeo are, in contrast, exempt clearing agencies that the Commission has

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<sup>64</sup> The Cornerstone Report states that interoperability is the key to competition in central matching services and notes that there are conditions in the respective orders that are designed to facilitate interoperability. The Cornerstone Report concludes that there are significant complexities associated with pricing in an interoperating central matching services marketplace, and that more careful analysis is needed to ensure that these complexities are resolved in a manner consistent with the Commission's mandate. See Cornerstone Report at 26–29.

<sup>65</sup> See BSTP August letter at 1 (citing Cornerstone Report at n.58).

authorized to provide certain services, subject to specific conditions as set forth in an exemptive order. The different approaches reflect the Commission's view that different types of clearing entities have different operating structures with different attributes that reflect different regulatory goals and objectives. The Commission believes that differences stemming from the types of clearing entity or service provided in this case support allowing multiple entities to act as matching service providers, and may lead to increases in efficiency in the market for matching services.<sup>66</sup>

DTCC also suggests that access to multiple matching service providers may increase the time necessary to route confirmations and affirmations between customers and service providers, which may interfere with market participants' ability to satisfy their obligations under Regulation SHO. DTCC also states that duplication of systems may result in multiple providers of Rule 10b-10 confirmations, resulting in unnecessary duplicate systems, additional costs, and an increased risk of errors.<sup>67</sup> The Commission also finds these arguments too speculative. First, as BSTP notes in its comment letter, the Cornerstone Report identifies a particular scenario whereby delays in the affirmation or matching process in connection with a long sale of securities occurs at NSCC and leads to delivery failures, which could occur within the existing market structure and is not specifically caused by the existence of multiple matching service

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<sup>66</sup> The Commission believes that these gains in efficiency may stem from increased competition and innovation in the market for matching services, as discussed below in Part III.B.3.

<sup>67</sup> See *supra* notes 59–60 and accompanying text. The Commission notes that it has addressed comments expressing concerns about duplicate systems above. In addition, the costs of establishing linkages are addressed below in Part III.B.2.iv. The potential for increases in systemic or operational risk are addressed, respectively, in Parts III.B.4 and III.B.5.

providers.<sup>68</sup> The Commission agrees that this example is not unique to an environment with multiple matching service providers and therefore finds the Cornerstone Report's assertions highly speculative. Second, the operational and interoperability conditions included in the Omgeo order are designed to limit communication errors or other delays by setting conditions with respect to interoperability among multiple matching service providers.<sup>69</sup> Regulation SCI,<sup>70</sup> which also applies to exempt clearing agencies subject to ARP,<sup>71</sup> further seeks to establish standards for connectivity, reliability, and resiliency to minimize the types of disruptions contemplated by DTCC. Third, the Commission notes that the examples of potential Regulation SHO violations presented in the Cornerstone Report, similar to the Rule 10b-10 comments discussed above, are speculative and more fundamentally unrelated to the concerns about efficiency raised by DTCC because, as BSTP also notes, the absence or presence of multiple confirmation service providers was not material or even relevant to the violations in question.<sup>72</sup> The Commission therefore believes that these DTCC comments are too speculative and attenuated to be persuasive.

In response to DTCC, BSTP counters that Omgeo actually impedes the move to a shortened settlement cycle by reducing the incentives for new providers to enter the market and

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<sup>68</sup> See BSTP August letter at 5.

<sup>69</sup> These conditions are also included below for BSTP and SS&C. See *infra* Part IV.A.2.ii (for BSTP) and Part IV.B.2.ii (for SS&C).

<sup>70</sup> See Exchange Act Release No. 34-73639 (Nov. 19, 2014), 79 FR 72251 (Dec. 5, 2014).

<sup>71</sup> Application of Regulation SCI to exempt clearing agencies is discussed in Part III.B.8.

<sup>72</sup> Specifically, as BSTP describes, one involved violations that persisted over four years and the other involved allegations of knowingly and willfully ignoring requirements. See BSTP August letter at 5 & n.19. The Commission notes that neither has circumstances implicating either the presence of multiple service providers or the linkages between them.

thereby attract market participants to use matching services. BSTP states that it intends to service, among others, investment managers, brokers, and custodians that currently rely on manual processes for post-trade matching of trade and allocation information. In particular, BSTP states that it will enable such investment managers to gain the benefits of an electronic matching service while continuing to use their existing workflows (fax, email, PDF, etc.) to send allocation instructions to their executing brokers, an important segment of market participants necessary to shorten the settlement cycle.<sup>73</sup> In contrast to the concerns raised by DTCC, BSTP states that transmission of matched settlement data without a direct electronic link to DTC would introduce a layer of inefficiency and complexity that would impair efforts to move to a shortened settlement cycle.<sup>74</sup> Consistent with BSTP's position, five other commenters also expressed the view that increasing the number of matching service providers, by increasing efficiency, would likely also facilitate moving to a shortened settlement cycle.<sup>75</sup> The Commission does not believe that expanding the scope of market participants engaged in matching services will impede industry efforts to shorten the settlement cycle because, in this situation, the availability of multiple matching service providers will provide market participants with more venues to match

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<sup>73</sup> See BSTP May letter at 8. BSTP also notes that increased resiliency is necessary to move to a shortened settlement cycle. See *id.* Comments related to resiliency (i.e., operational risk) are addressed in Part III.B.5.

<sup>74</sup> See BSTP August letter at 4. Comments regarding access to DTC were addressed above in Part III.B.2.i.

<sup>75</sup> See AllianceBernstein at 1; Capital Market Solutions; Puskuldjian; SIFMA AMF at 1; Traiana.

their trades in a timely, efficient manner, thereby increasing the potential for a higher global rate of affirmed trades within the current settlement cycle.<sup>76</sup>

iii. Management of Control Numbers

Related to DTCC's concerns regarding efficient access to DTC, DTCC also raises concerns about how, under a multiple access model, control numbers used to identify trades throughout the trade lifecycle would be assigned. First, DTCC explains that DTCC TradeSuite ID, which is part of Omgeo, provides control numbers to market participants upon receiving the trade data input from the executing broker-dealer.<sup>77</sup> DTCC states that issuing control numbers from DTC, rather than TradeSuite ID, would require substantial system changes, either through building a new system within DTC or transferring the TradeSuite ID control number issuance capability to DTC.<sup>78</sup> Second, DTCC notes that there are potential benefits to centralizing this data. For example, DTCC states that centralization of time-stamped trade records at DTCC has permitted the settlement agents and DTC to more efficiently and effectively settle trades that failed to settle on the scheduled settlement date, while allowing market participants to reconstruct trades and even unwind them when appropriate.<sup>79</sup>

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<sup>76</sup> See Exchange Act Release No. 34-49405 (Mar. 11, 2004), 69 FR 12922, 12926 (Mar. 18, 2004) (noting that it is generally accepted that a substantial portion of the risks in a clearance and settlement system is directly related to the length of time it takes for trades to settle and that, in other words, time equals risk).

<sup>77</sup> See DTCC April letter at 15

<sup>78</sup> See id.; see also Cornerstone Report at 19–22. The Commission notes, however, that, in its comments regarding the timeframes for building and operating interfaces, DTCC identifies assignment of control numbers as one of the functionalities it will need to develop with BSTP and SS&C to ensure interoperability consistent with the conditions of the Omgeo order. See infra Part III.B.7.ii.

<sup>79</sup> See DTCC April letter at 7.

The Commission agrees that there are potential benefits to centralizing trade data in a single repository. Indeed, BSTP states that the creation of the control number, the transmission of the control number to the parties involved in settlement, and the transmission of settlement instructions to DTC are critical components of post-trade processing, and, as such, are elements of the national clearance and settlement system that ought to be provided on a fair and non-discriminatory basis by DTC.<sup>80</sup> BSTP further notes, however, that even if the Commission were to continue to allow DTC to outsource issuance of control numbers to Omgeo, DTC could simply allow BSTP to generate its own control numbers on DTC's behalf. BSTP states that, whatever the approach, it is capable of enriching a confirmation with a control number, thereby providing the same benefit of efficiently and effectively settling trades, as provided by the existing infrastructure.<sup>81</sup>

DTC rule change SR-DTC-2001-11 was approved to allow DTC to accept and act upon instructions provided by a matching service provider, and if centralization of trade data is necessary for such settlement, DTC has undertaken, in its capacity as a registered clearing agency and SRO, to perform such services.<sup>82</sup> Further, centralization of trade data remains possible under a multiple access model supported by consistent data standards and identifiers. In this regard, BSTP notes that DTC could ensure that control numbers generated by BSTP are

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<sup>80</sup> See BSTP May letter at 14.

<sup>81</sup> See id.

<sup>82</sup> See supra Part III.B.2.i.

distinguishable from those generated by Omgeo by requiring, for example, use of a “B” prefix for the former and an “O” prefix for the latter.<sup>83</sup>

iv. Costs of Linkages

DTCC states that both the DTCC complex and market participants would face increased costs if the multiple access model contemplated by the BSTP and SS&C applications were implemented, and that the risks and costs of building and testing these connections would multiply exponentially as additional matching service providers enter the market.<sup>84</sup> DTCC states that the Commission should therefore allow the industry to avail itself of the systems and controls that have already been established through Omgeo, an industry-owned utility.<sup>85</sup> First, DTCC states that DTC would have to develop, build, and maintain new systems to interoperate with BSTP and SS&C. DTCC states that it would have to modify its internal systems and network management infrastructure and build in capabilities to prepare for the possibility of additional central matching services with direct access to DTC, and that BSTP and SS&C would also incur substantial costs.<sup>86</sup> DTCC states that, as DTC’s systems become more complex, DTC’s maintenance requirements would also become more complex and costly, costs which would be borne by industry participants and ultimately investors. According to DTCC, these

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<sup>83</sup> See BSTP May letter at 14 n.41.

<sup>84</sup> See DTCC April letter at 11

<sup>85</sup> See DTCC April letter at 11; Cornerstone Report at 18–19.

<sup>86</sup> Specifically, DTCC states that BSTP and SS&C would be required to (i) implement a redundant fault tolerant network design, including interfaces that ensure robust security protocols and processes based on DTCC standards, and (ii) build access to the custodian/settlement agent community to implement the multiple access model, imposing significant time, cost and other resources on BSTP, SS&C, and the custodians/settlement agents, costs that DTCC states would inevitably be passed on to investors. See DTCC April letter at 11.

additional costs would also require DTC to reprioritize other critical projects, thereby potentially delaying important industry initiatives intended to make the national clearance and settlement system more secure and efficient.<sup>87</sup> Second, DTCC states that market participants involved in the settlement of trades matched by BSTP and SS&C would need to develop, build, and maintain new interfaces and reengineer internal systems to receive and process messages from BSTP and SS&C. DTCC also states that market participants would inevitably bear at least some of the costs incurred by DTC, BSTP, and SS&C, as those costs are passed on to investors.<sup>88</sup>

With respect to the implementation of new network designs and interfaces, and the provision of access, the Commission is unpersuaded that the prospect of additional expenses merits denial or modification of the applications. The Commission acknowledges that the entry of BSTP and SS&C into the market for matching services may initially result in additional investments by BSTP, SS&C, Omgeo, and DTC, as well as potentially a number of other market participants who rely upon such entities in various capacities. Neither DTCC nor any of those entities quantified the associated costs, however. The Commission expects that, as for-profit entities, neither BSTP nor SS&C would choose to bear these costs, including costs passed through from DTC, unless either believed it could do so profitably. While there may be initial costs required to establish new linkages, these new linkages will introduce competition and choice into the market for matching services, providing new opportunities for innovation that may reduce costs to market participants in the long run, as discussed further below. Indeed, there was unanimity in the comments by market participants about the impact on costs passed

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<sup>87</sup> See id. at 12.

<sup>88</sup> See id. at 11; Cornerstone Report at 24.

down to them: twenty-three market participants or industry groups commented on the BSTP application and expressed no concerns about costs being passed on to them. Rather, as noted previously, many of the commenters stated the opposite—that the introduction of new matching service providers would reduce costs to industry.<sup>89</sup>

With respect to implementation difficulties, the Commission is unpersuaded that the prospect of expenditures merits denial or modification of the applications. As previously discussed, both Omgeo and DTC agreed to a number of conditions that anticipated, and were designed to facilitate, the possibility of new matching service providers.<sup>90</sup> The Commission notes that neither DTCC nor the Cornerstone Report provided concrete descriptions of which critical projects would be delayed, or for how long. Further, as a registered clearing agency, DTC has obligations under Section 17A(b)(3)(F) of the Exchange Act to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, which it cannot abrogate due to cost. To the extent that DTCC reprioritizes projects, entities within the DTCC complex registered pursuant to Section 17A of the Exchange Act must continue to meet their legal and regulatory obligations.

### 3. Competition, Choice, and Innovation

Section 17A of the Exchange Act directs the Commission, in facilitating the establishment of the national clearance and settlement system, to have due regard for, among other things, maintenance of fair competition among clearing agencies.<sup>91</sup> Below is an overview

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<sup>89</sup> See, e.g., infra note 94 and accompanying text regarding reduced costs.

<sup>90</sup> See supra notes 37–50 and accompanying text.

<sup>91</sup> See 15 U.S.C. 78q-1(a)(2)(A).

of comments related to competition. The Commission also received comments about choice and innovation, which are discussed below.

One commenter states explicitly that approving the BSTP application would be consistent with the objectives of Section 17A of the Exchange Act and investor protection by promoting the integrity of the financial markets.<sup>92</sup> DTCC, however, states that it is unclear whether the national clearance and settlement system can effectively sustain competition among multiple matching services and that the outcome of such competition may be that a for-profit entity becomes the primary provider of matching services. DTCC questions whether a for-profit entity like BSTP or SS&C can ensure that pricing decisions will be undertaken in a way that benefits the long-term best interest of the industry.<sup>93</sup>

There was unanimous support for new entrants to provide matching services. Several commenters anticipated that additional providers of matching services would yield benefits, namely increases in competition, choice, and innovation within the market for matching services.<sup>94</sup> Twelve commenters identified as a related benefit a reduction in costs to market participants generally.<sup>95</sup> In addition, four commenters cited BLP's role in BSTP's proposed

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<sup>92</sup> See SIFMA AMF at 2.

<sup>93</sup> See Cornerstone Report at 5–6, 29–30.

<sup>94</sup> See AllianceBernstein at 1; Altieri; Anonymous; Connolly; Denci; Dore; Durant; Fidessa; James; Lang; Matthews; McCafferty; Naratil; Northern Trust; Puskuldjian; Scuteri; SIFMA AMF at 1–2; Traiana.

<sup>95</sup> See AllianceBernstein at 1 (noting that reduced costs would be a natural economic byproduct of the increased availability of service providers, promoting trading and liquidity in the market); Ambos (noting that Omgeo's matching service potentially charged its group three times, as broker-dealer, outsourcer, and custodian, which the commenter stated may not be necessary if BSTP offers a matching service); Capital Market Solutions (noting that the ability to choose between matching services on a per-trade basis will help firms test services without

matching service and BLP's overall reputation as positive aspects of the BSTP application.<sup>96</sup> BSTP states that its application will promote fair competition, consistent with Section 17A(a)(2)(A),<sup>97</sup> and SS&C similarly notes that its application would allow for competition in the area of institutional trade matching.<sup>98</sup> In its comment letters, DTCC generally expressed support for the promotion of competition in service offerings to customers, including ETC and matching services to registered broker-dealers, investment managers, and custodians/settlement agents. DTCC states that competition in service offerings, including ETC and matching services to registered broker-dealers, investment managers, and custodians/settlement agents, may permit useful innovation and product alternatives, to the benefit of industry participants and ultimately to investors.<sup>99</sup>

Despite general agreement on the benefit of competition among matching service providers, DTCC and the applicants disagreed on the specific terms under which new entrants would compete with Omgeo, the only current matching service provider. DTCC states that the conditions on access and pricing in the BSTP and SS&C notices should be reconsidered. While noting that the conditions are substantially the same as those imposed on Omgeo, DTCC offers

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having to invest in a large upfront cost); Connolly (noting that competition keeps prices at market rates); James; Lang (noting that adding a capable competitor in the post-trade processing space will lead to innovation which will ultimately result in lower transaction costs); Puskuldjian; Ransford; Scuteri (noting that competition allows the free market to dictate fair pricing); SIFMA AMF at 2; Traiana; see also Dore (noting that the absence of competition results in a lack of fee transparency).

<sup>96</sup> See Altieri; Connolly; James; Ransford.

<sup>97</sup> See BSTP May letter at 4; see also 15 U.S.C. 78q-1(a)(2)(A).

<sup>98</sup> See SS&C letter at 1.

<sup>99</sup> See DTCC June letter at 2; DTCC May letter at 2; DTCC April letter at 2.

several bases for modification: changes in the marketplace (including DTCC's 2013 purchase of Thomson Financial's outstanding ownership interest in Omgeo), differences in the ownership and governance of Omgeo and the applicants, differences in the related services offered by applicants' affiliates, differences in the pricing structures of Omgeo and the applicants, and changes in law and regulation since 2001.<sup>100</sup> DTCC states that the pricing and access conditions in the Omgeo order derived largely from concerns that central matching, which at the time was provided by DTC as an industry utility, would be performed by a separate for-profit entity in Omgeo. According to DTCC, the concern was that Omgeo could restrict competitors' access to DTC and give Omgeo an unfair advantage through differential pricing, lack of interoperability, and preferential treatment of Omgeo's clients by DTC. Therefore, Omgeo represented in its request for an exemption that it would not impose prohibitions or limit access to its services by potential customers, though it might terminate a subscription for failure to pay fees. According to DTCC, now that Omgeo is a wholly-owned subsidiary of DTCC, it does not compete with BSTP or SS&C for customers, while BSTP and SS&C are for-profit entities and therefore subject to the incentive to limit access to competitors.<sup>101</sup> DTCC says the Commission should impose on BSTP, and where applicable BLP, pricing and access conditions appropriate to the specific roles of each within the national market system and the national clearance and settlement system.<sup>102</sup>

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<sup>100</sup> See DTCC April letter at 18–19.

<sup>101</sup> See DTCC April letter at 18–19; DTCC May letter at 16; Cornerstone Report at 5–6.

<sup>102</sup> See DTCC April letter at 19; Cornerstone Report at 5–6. For purposes of the below discussion, the Commission assumes that DTCC would seek to impose the same on SS&C and its parent company and/or affiliates.

In response to DTCC's comments above, SS&C comments that it is not for DTCC to determine the affordability of its offering but rather for the marketplace to decide. SS&C states that it is fully committed to honoring the pricing and access conditions set forth in the SS&C application and notice. SS&C also notes that while Omgeo may not compete for customers in the United States, it does in other jurisdictions, including Canada, where Omgeo and SS&C are already direct competitors.<sup>103</sup>

DTCC also raises several competition concerns specific to the BSTP application. First, DTCC questions whether BSTP might bundle its matching service with other BLP services, raising potential antitrust concerns by creating a disincentive for BLP customers to use Omgeo's matching service. DTCC states that BLP should clarify its intentions with regard to bundled pricing and that the Commission should clarify whether BSTP may offer different prices to distinct groups of customers while requiring fair access to BSTP's matching service. DTCC also requests that any determination to grant BSTP an exemption be expressly conditioned on BSTP not engaging either in tying of its matching service to other BLP services or in bundled pricing with respect to its matching service. DTCC requests that BSTP be required to make its matching service "separately available" to someone who does not wish to purchase any other BLP service.<sup>104</sup> Second, DTCC questions whether BSTP might deplete Omgeo's high-volume customer base, requiring Omgeo to either (i) raise prices on its remaining customers to cover its fixed costs or (ii) leave prices unchanged, thereby through DTCC subsidizing BLP's operations. DTCC stated that BSTP, as a for-profit entity, should not be allowed to provide matching

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<sup>103</sup> See SS&C letter at 5.

<sup>104</sup> See DTCC April letter at 21 & n.64.

services in an anti-competitive manner by targeting solely larger, more actively trading end-users while not permitting fair access to smaller, less active end-users. In this regard, DTCC also states that BSTP should not be allowed to condition use of its matching service on customers renting Bloomberg Terminals.<sup>105</sup>

In response to the multiple comments summarized above, BSTP comments that DTCC's assertion of potential antitrust concerns has no merit and that DTCC does not offer any logical explanation of how approving the BSTP application, and thereby introducing Omgeo's first competitor, could harm competition, but notes that it may affect Omgeo's current monopoly and DTCC's own business interests.<sup>106</sup> BSTP also responds that there is nothing unusual or pernicious in the fact that BSTP will be a for-profit business, noting that many SEC-regulated entities, including those operating pursuant to exemptions, are for-profit. Indeed, BSTP further notes that, in the Omgeo order, the Commission observed that Omgeo would be operated on a for-profit basis.<sup>107</sup>

Lastly, DTCC states that the Commission should require conditions on access to BSTP's FailStation product that are similar to those required for Omgeo's ALERT service and contained in the Omgeo order. DTCC cites BSTP's own description of FailStation as an industry utility that aggregates failed trade and settlement pre-matching data from all trade counterparties in real time into a single report for the investment manager, custodian, and broker. DTCC draws parallels between access to FailStation and access to ALERT, noting that commenters expressed

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<sup>105</sup> See id. at 19 & n.59.

<sup>106</sup> See BSTP May letter at 22.

<sup>107</sup> See id. at 19–20 n.59.

concerns about access to ALERT after the creation of Omgeo, and the conditions were included to provide assurances that other central matching services and persons that represent or otherwise provide services to customers (i.e., end-users) of Omgeo would have access to ALERT on fair and reasonable terms.<sup>108</sup> BSTP responds that FailStation is a product offered by Bloomberg Finance LP and is made available to all market participants who wish to purchase it, and accordingly there is no reason to impose a regulatory obligation on BSTP to ensure FailStation remains accessible to market participants. In discussing the comparisons made by DTCC between FailStation and Omgeo's ALERT service, BSTP states that the two are completely different services because ALERT is a database of customer relationship information and settlement data that is shared by institutions, broker-dealers, and custodians. According to BSTP, FailStation is, by contrast, a tool that allows users of BSTP's service to monitor and manage pre- and post-settlement exceptions for a particular trade in real time.<sup>109</sup>

Because of the interconnected nature of DTCC's many concerns raised above regarding the appropriateness of the access and pricing conditions contained in the BSTP and SS&C notices, the Commission will address them together. With respect to the absence of access and pricing conditions within the BSTP and SS&C applications reflective of their role in the marketplace, the Commission is unpersuaded that the prospect of bundling services, cross-subsidization of services, profitability, restrictions on access to unrelated services, and other like concerns merits denial or modification of the applications. To clarify, the Commission disagrees with DTCC's characterization of the historical purpose of these conditions under the Omgeo

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<sup>108</sup> See DTCC April letter at 20 & n.63.

<sup>109</sup> See BSTP May letter at 26 & n.83.

order as being tied to any particular applicant's ownership model or any particular marketplace structure.<sup>110</sup> As the Commission stated in the Omgeo order, the Commission intended to require substantially the same conditions for other matching service providers,<sup>111</sup> and did not distinguish among future hypothetical applicants on the basis of their non-profit or for profit status, governance structures, affiliated companies, or other factors related to the marketplace as a whole. Instead, these conditions were intended to assure that matching service providers other than Omgeo receive equal treatment by DTC, an affiliate of Omgeo.<sup>112</sup> Additionally, the Commission does not see how Omgeo's status as a subsidiary of DTCC affects whether it will compete with BSTP and SS&C. That Omgeo does not compete with any other matching service provider currently is solely a reflection of its position as the only current matching service provider in the U.S. market. Moreover, DTCC's comments, including its concern the BSTP may deplete Omgeo's high-volume customer base, demonstrate that DTCC does anticipate competing with BSTP and SS&C for customers, in line with the Commission's expectation that market forces resulting from the introduction of multiple matching service providers would necessarily drive customer choice in this regard.

The Commission also disagrees with DTCC's attempts to draw a parallel between the role that DTC and associated settlement system products (such as ALERT) play in the national clearance and settlement system and the role that Bloomberg Terminals, FailStation, and other BLP products play in the national clearance and settlement system. Despite any promotional

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<sup>110</sup> See, e.g., DTCC April letter at 18–19; see also DTCC May letter at 16.

<sup>111</sup> See Omgeo order, supra note 37, at 20498.

<sup>112</sup> See id.; see also supra note 43 and accompanying text.

claims that such products are industry utilities, from a regulatory perspective, Bloomberg Terminals, FailStation, and other BLP products primarily provide functionality for executing trades rather than clearing and settling trades. DTC, in contrast, as a registered clearing agency and the CSD for U.S. equities, is a critical element of the national system for clearance and settlement. In addition, the arguments presented by DTCC raising concerns over the potential for BSTP to bundle are speculative and the Commission believes that allowing market forces to determine whether bundling, Bloomberg Terminals access, or any other factor influences either high- or low-volume customer choice to be appropriate at this juncture.

With respect to modifying the conditions as applied to SS&C and BSTP, the Commission believes that market conditions continue to support consistent treatment across matching service providers. The Commission believes that a potential overlap in targeted customer bases between the applicants and Omgeo is not a sufficiently compelling reason to support modifying the conditions because the conditions were included to facilitate competition and that necessarily implied competition for customers.

With respect to innovation, both BSTP and SS&C state that their applications will promote new data processing techniques and technology-driven solutions. For example, SS&C states that its service stands out in terms of its flexibility,<sup>113</sup> while BSTP states that its offering stands out in terms of potential synergies with other tools currently used.<sup>114</sup> Congressional findings cite to techniques that create the opportunity for more efficient, effective, and safe procedures, and the Commission believes that the description of services in the BSTP and SS&C

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<sup>113</sup> See BSTP letter at 3–4.

<sup>114</sup> See SS&C letter at 3.

applications may promote such opportunities, which are consistent with the public interest and the protection of investors.

On balance, the Commission believes that the access and pricing conditions in the BSTP and SS&C notices would promote fair competition. New entrants such as BSTP and SS&C could foster competition in the provision of matching services by competing with Omgeo by reducing the cost of matching services to broker-dealers and institutional customers or increasing the quality or type of services offered. Competition, in turn, could foster innovation in the market for matching services, resulting in more efficient matching and communications systems.

i. Impact of Applicants' Workflows on Competition, Choice and Innovation

Competition, choice, and innovation are not only addressed by commenters in the context of the general prospect of new entrants BSTP and SS&C, but also within the context of the discussion raised by DTCC regarding BSTP and SS&C's multiple access model workflow and DTCC's alternative single access model workflow. DTCC states that the Commission should distinguish competition in central matching from competition in access to settlement and related functions (e.g., providing internal control numbers and sending matching confirmation and settlement instructions to settlement agents and DTC). The Commission has previously described DTCC's position that the single access model is the optimal way to support competition in matching in Part III.B.2.i.<sup>115</sup> DTCC states that requiring BSTP and SS&C to send trade instructions to DTC solely through the existing infrastructure would not impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act because it would be justified by the benefits to the clearance and settlement system resulting

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<sup>115</sup> See DTCC June letter at 2-3; DTCC May letter at 2; DTCC April letter at 3.

from greater visibility for DTC and its participants into pre-settlement trade activity, enabling firms to correct errors before fails occur and reducing the number of places in the trade lifecycle where an error in settlement could occur without imposing additional costs on industry, as DTCC states the multiple access proposal would.<sup>116</sup>

In response, BSTP states that using Omgeo, as DTCC proposes, creates an unjustified barrier to entry, discouraging vendors from entering the matching services business because of the limited scope of services they would be able to provide outside Omgeo and because a competitor, Omgeo, would continue to control certain basic matching services functions. For example, BSTP states that such a workflow would place a competitor between the matching service provider and DTC, and between the matching service provider and custodians and settlement agents.<sup>117</sup> BSTP states that DTCC's recommendation to use Omgeo reflects a fundamental conflation of DTCC's commercial interests as an unregulated holding company with the regulatory obligations of its subsidiaries, including DTC and Omgeo. BSTP further notes that the Cornerstone Report focuses primarily on how the approval of the BSTP application could affect Omgeo and Omgeo's business model, which BSTP states is itself rooted in a de facto monopoly over matching services. BSTP notes that DTC is subject to the full range of requirements under Section 17A of the Exchange Act while Omgeo is subject to the terms of the Omgeo order. BSTP states that DTCC fails to distinguish between its own corporate business interests and the requirements applicable to DTC under the Exchange Act and Omgeo under the

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<sup>116</sup> See DTCC April letter at 14 n.45.

<sup>117</sup> See BSTP May letter at 6-7.

Omgeo order.<sup>118</sup> BSTP also states that mandating usage of Omgeo would hamper innovation because it would preserve the status quo, eliminating incentives for DTCC and its affiliates to innovate or to upgrade or improve infrastructure.<sup>119</sup>

BSTP states that direct access to DTC is essential to the matching services concept and critical to the national system for clearance and settlement. BSTP states that DTCC's recommendation for a single-access model draws a fundamentally incorrect and inappropriate dichotomy by highlighting the distinction between matching services and access to settlement functions because it suggests that a matching service consists only of the internal function of comparing data and not the function of transmitting an affirmed confirmation to DTC. BSTP notes that previous Commission statements have clarified that a matching service seeking an exemption from registration as a clearing agency would be required to establish an electronic link to a registered clearing agency that provides for the settlement of its matched trades.<sup>120</sup> According to BSTP, this recognizes that the capability of a matching service to send affirmed trades directly to DTC is critical to a safe and sound process for clearing and settling trades in the national clearance and settlement system, and that mandating the use of Omgeo would frustrate and impair the benefits that matching services bring to market participants.<sup>121</sup>

BSTP also states that mandating the use of Omgeo would be inconsistent with DTC's obligations as a registered clearing agency. Citing Section 17A(b)(3)(F) and (I) of the Exchange

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<sup>118</sup> See id. at 8-9.

<sup>119</sup> See id. at 7.

<sup>120</sup> See id. at 9. For discussion of previous Commission statements on the requirements that an entity seeking an exemption to provide matching service would need to satisfy, see the Matching Release, supra note 13, at 17947 n.28.

<sup>121</sup> See BSTP May letter at 10.

Act, BSTP states that DTC has an obligation to maintain rules that foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, that remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and that do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. BSTP states that mandating the use of Omgeo would be inconsistent with these obligations because DTCC would have the Commission adopt a requirement that favors one or more of DTCC's wholly-owned subsidiaries when Section 17A imposes an affirmative obligation to facilitate the development of matching services in a manner that does not burden competition and that facilitates the linking of clearance and settlement facilities.<sup>122</sup>

BSTP notes that access to DTC was a major concern when the Commission issued the Omgeo order, and the Commission has above already assessed DTC's arguments regarding efficient access to DTC against the historical background to the Omgeo order and related DTC rule filings.<sup>123</sup> For example, citing DTCC's comment letters from that period, BSTP states that, in moving TradeSuite to Omgeo, DTCC promised that vendors acting on behalf of DTC participants will be able to transmit settlement instructions directly to DTC without the involvement of Omgeo.<sup>124</sup> BSTP also cites DTCC's comment letter stating that it shall not favor any single matching service provider over any other in terms of the quality and caliber of the interface to DTC's clearing agency or settlement functions, quality of connectivity, receipt of

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<sup>122</sup> See id.

<sup>123</sup> See supra notes 37–50 and accompanying text.

<sup>124</sup> See BSTP May letter at 10.

delivery and payment orders, speed or processing of delivery and payment orders, capacity provided, or priority assigned in processing delivery and payment orders. BSTP also cites DTCC's statement that DTC's longstanding practice of providing members of the financial industry with equal, standardized access to DTC's services will continue after the formation of Omgeo, and that such practice is required by Section 17A of the Exchange Act and subject to Commission oversight.

Further, BSTP states that mandating the use of Omgeo would require DTC to propose an unjustifiable rule change. BSTP notes that, as a registered clearing agency, DTC is a rules-based organization, and BSTP further notes that DTCC has cited to no rule that would require matching services to use Omgeo to access DTC. BSTP states that, if DTC wished to adopt such a requirement, it would be required to submit a proposed rule change, subject to notice, public comment, and Commission review and approval. BSTP notes that DTC has not submitted such a proposed rule change and further notes its belief that any such proposed rule change would be unsupported under the Exchange Act.<sup>125</sup>

SS&C states in its letter that it is in complete agreement with BSTP's response on matters where the concerns raised by DTCC are substantially the same between the BSTP and SS&C applications, including the single versus multiple access question.<sup>126</sup> Separately, SS&C also notes that, under DTCC's proposal for a single access model, competition as it relates to institutional post-trade processing would be confined to central matching while all other key ancillary services would remain outside this scope, subject to DTCC control as part of Omgeo.

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<sup>125</sup> See id. at 12.

<sup>126</sup> See SS&C letter at 4.

As noted previously, SS&C infers from DTCC's position that Omgeo would impose the same charges on competing matching services as they do on clients today and states that, should the Commission accept this position, SS&C doubts that any service would find it economically viable to enter the market for post-trade services to compete with Omgeo.<sup>127</sup>

The Commission is unpersuaded that, in considering the prospect of competition among matching service providers, it must find that a single, direct link to DTC through Omgeo is the only outcome sufficient to support approval of the BSTP and SS&C applications. As discussed previously, the Commission has already approved DTC rule change SR-DTC-2001-11, which authorized DTC to accept from a matching service provider a file of deliver order instructions to settle transactions between DTC participants that have authorized DTC to accept such instructions from the matching service provider.<sup>128</sup> The Commission notes that DTCC states that its Investment Management System ("IMS") may receive deliver orders from multiple sources, including Omgeo as well as other matching service providers.<sup>129</sup>

Further, the Commission is unpersuaded that it should deviate from this existing regulatory framework because of DTCC's proposed vision for how competition among matching service providers could work. As discussed above, the Commission notes that it has previously described its expectation that an entity seeking an exemption as a matching service provider

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<sup>127</sup> See SS&C letter at 3. For prior discussion of these expected surcharges, see Part III.B.2.i, and supra notes 53–54 and accompanying text.

<sup>128</sup> See supra notes 47–50 and accompanying text.

<sup>129</sup> See DTCC, Inventory Management System, available at <http://www.dtcc.com/asset-services/settlement/inventory-management-system> (last accessed Nov. 2, 2015) (discussing IMS transaction types, including code "MITS"—matched institutional deliveries sent to IMS from Omgeo or another matching utility).

would be required to establish an electronic link to a registered clearing agency that provides for the settlement of its matched trades.<sup>130</sup> The Commission specifically expressed concern about the concentration of risk that occurs in an entity that performs matching services instead of dispersing that risk more broadly to broker-dealers and their institutional customers. The Commission's concerns regarding concentration of risk—whether through aggregation of activity in multiple matching service providers, or further aggregation of trade enrichment activity under a single access model—remain unchanged from those expressed in the Matching Release, even if multiple links to DTC result in some implementation costs.

#### 4. Systemic Risk

Within the concept of requiring linked or coordinated facilities for clearance and settlement of securities transactions is the implication that any one facility that is connected to other facilities could generate externalities that can affect the system as a whole. If such externalities can create disruptions to the national system for clearance and settlement, then the prospect of such systemic risk implicates facilitating the establishment of linked or coordinated systems.

The Commission received multiple comments addressing the expected effect of the BSTP and SS&C applications on systemic risk. BSTP notes in its comment letter that the BSTP application promotes investor protection by providing a prompt and accurate matching service that eliminates a single point of dependency in the current market infrastructure for matching services, thus enhancing the robustness of the clearance and settlement system.<sup>131</sup> As noted

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<sup>130</sup> See Matching Release, supra note 13, at 17947 n.28.

<sup>131</sup> See BSTP May letter at 3; see also BSTP August letter at 2–4.

above, BSTP also highlights that its application promotes efficiency by enabling straight-through processing throughout the entire trade lifecycle, which it states will contribute to increases in same-day affirmation rates and in settlement rates.<sup>132</sup> As to SS&C, as noted above, SS&C states that it is in agreement with BSTP on those points that overlap between the BSTP and SS&C applications.<sup>133</sup>

Multiple commenters agree with BSTP and SS&C. Ten commenters note that increasing the number of matching service providers would remove the single point of dependency present in the existing market infrastructure for matching services, decreasing the risks associated with a single point of failure.<sup>134</sup> Similarly, four commenters cite improved confirmation/affirmation rates overall as anticipated benefits of having multiple matching service providers,<sup>135</sup> and one of those commenters also notes the related benefit of a likely reduction in settlement fails.<sup>136</sup> An additional commenter supports the approval of additional providers of matching services where the matching service (i) supports standardized message formats and processing procedures, (ii) adheres to interoperability principles with current and future providers, (iii) accommodates increased volume on a scalable basis sufficient to function as a continuity of business alternative

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<sup>132</sup> See id.; see also supra note 31 and accompanying text.

<sup>133</sup> See supra note 24 and accompanying text.

<sup>134</sup> See AllianceBernstein at 1; Ambos; Capital Market Solutions; Connolly; Denci; Fidessa; Northern Trust; Ransford; Scuteri; SIFMA AMF at 2.

<sup>135</sup> See Capital Market Solutions; Lang; Matthews; Puskuldjian.

<sup>136</sup> See Puskuldjian.

in the event other providers experience operational issues or failure, (iv) facilitates a shortened settlement cycle, and (v) supports straight through processing.<sup>137</sup>

In its comment letters and in the Cornerstone Report, however, DTCC raises multiple concerns about the effect of the applications on systemic risk. Central to the disagreement between the applicants and DTCC is whether BSTP and SS&C should have direct access to DTC. Further, to the extent that BSTP and SS&C have direct access to DTC, DTCC states that such linkage arrangements may increase systemic risk to the market's settlement infrastructure. DTCC also disagrees with commenters stating that the BSTP and SS&C applications will alleviate the single point of dependency problem that exists in the current market infrastructure, stating that a single market participant is unlikely to subscribe to two separate matching service providers and therefore not increase the resiliency that results from redundant systems.<sup>138</sup> In addition, DTCC raises other concerns regarding the solvency of BSTP, SS&C, their respective parent companies, and their respective affiliates; the resiliency of SS&C, its parent company, and its affiliates; and the volume limits represented in the SS&C application.

i. Single Point of Dependency

First, BSTP states that Omgeo represents a single point of failure for matching services because it is the only means of accessing DTC for settlement.<sup>139</sup> BSTP states that a resilient

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<sup>137</sup> See Citi at 1–2. The Commission notes that the aspects of this comment are addressed throughout this order: concerns related to standardized messaging formats and processing procedures are discussed in Parts III.B.2.i, iii, and iv; concerns related to the sufficiency of an applicant to provide a business continuity alternative are discussed in Part III.B.5; concerns related to interoperability are discussed in Part III.B.7; and concerns related to a shortened settlement cycle and straight-through processing are discussed in Part III.B.2.ii.

<sup>138</sup> See Cornerstone Report at 4–5.

<sup>139</sup> See BSTP May letter at 6.

environment is needed in matching services, which can be achieved through the introduction of additional matching service providers if they are allowed to establish separate, redundant connections to DTC and market participants.<sup>140</sup> BSTP states that centralization of records is worrisome and that introducing an additional venue for storing records will benefit the marketplace by alleviating reliance on a single entity.<sup>141</sup> BSTP notes that a single access model would prevent the establishment of separate, direct connections to DTC and therefore eliminate the benefit that multiple pathways would provide, such as alleviating message traffic congestion during high volume trading periods (such as near the time of market close). In its comment letters, BSTP states that it will provide increased resiliency by providing an alternative means for affirmed confirmations to be transmitted to DTC, custodians, and settlement agents.<sup>142</sup>

DTCC counters that allowing both BSTP and SS&C to access DTC directly would increase systemic risk relative to a single access model because a single access model has fewer interfaces within the market infrastructure that provides matching services, meaning fewer potential points of failure, less complexity, and therefore less risk to the national clearance and settlement system.<sup>143</sup> DTCC also notes that, under the current model, when a broker-dealer executes an institutional trade, they provide a trade record and Omgeo assigns a control number to be used throughout the trade lifecycle, allowing DTC, market participants, and regulators to

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<sup>140</sup> See BSTP August letter at 3–4. BSTP cites to recent events in which the presence of multiple service providers and points of connectivity helped facilitate trading on alternate trading venues when the primary listing venue suffered a disruption. See *id.* at 4 & n.12.

<sup>141</sup> See *id.* at 17.

<sup>142</sup> See *id.* at 8.

<sup>143</sup> See DTCC April letter at 11, 13; Cornerstone Report at 6, 23.

track the phases of one or more trades over time.<sup>144</sup> In addition, the Cornerstone Report states that a multiple access model can only reduce the single-point-of-dependency problem during a matching service provider outage when the two parties to a trade have access to multiple matching service providers and can easily transition from using one to using the other.<sup>145</sup> The Cornerstone Report also states that, even if a second market entrant could feasibly provide matching services, further complexities may arise when additional entrants become matching service providers.<sup>146</sup>

The Commission notes that it has already addressed several arguments related to efficiency concerns regarding access to DTC in Part III.B.2.i. On the single point of dependency question, the Commission agrees with BSTP and disagrees with DTCC. As DTCC correctly notes, the risk that the clearance and settlement system would fail during times of market stress, such as the 1987 market break, has been described as the single most important threat to the U.S. financial system, and that settlement failures, if widespread, can have a systemic impact on the national clearance and settlement system while imposing significant costs on market participants.<sup>147</sup> As described above, the Commission maintains the concerns it expressed within the Matching Release with respect to concentration of processing risk in a single matching service provider.<sup>148</sup> On balance, the Commission believes that the redundancy created by more interfaces and linkages within the settlement infrastructure increases resiliency, as suggested by

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<sup>144</sup> See DTCC April letter at 7; DTCC May letter at 3–15.

<sup>145</sup> See Cornerstone Report at 23–24.

<sup>146</sup> See *id.* at 41.

<sup>147</sup> See DTCC April letter at 1–2, 3.

<sup>148</sup> See Matching Release, *supra* note 13, at 17946.

BSTP. In the event of a disruption in services at Omgeo, the redundancy facilitated by the addition of matching services provided by BSTP and SS&C makes it more likely that market participants can continue to match and settle trades than if Omgeo stands as a necessary intermediary for settlement at DTC.

The Commission acknowledges, as noted by DTCC, that in order for one matching service provider to facilitate redundant access to DTC in the event Omgeo or another matching service provider experiences a disruption, customers will need to have access to multiple matching service providers. The Commission notes that, unlike participants in a CCP, customers of a matching service provider are not subject to requirements to determine suitability for membership. Because obtaining access to a matching service provider is not subject to determinations regarding suitability for membership, the Commission expects that customers could gain access to a secondary matching service provider with enough ease to meaningfully reduce disruption to the marketplace, as compared to a scenario where access to DTC is not redundant.

With respect to the direct links proposed by the BSTP and SS&C applications, the Commission is unpersuaded that the prospect of increased technical complexity merits denial or modification of the applications. As BSTP notes in its comment letter, technological improvements since approval of the Omgeo order have increased the ability to establish safe and secure communication links.<sup>149</sup> Further, BSTP states that there is nothing new or unique about the activities that will be required of DTC to establish an interface with BSTP. BSTP states that it would expect to use the same protocol as Omgeo, and notes that the comment letters

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<sup>149</sup> See BSTP May letter at 11.

demonstrate that market participants do not view linkage requirements as disadvantageous.<sup>150</sup>

According to BSTP, whether the trade instructions are in a proper format requires only the use of an agreed protocol. BSTP further states that BSTP's matching service will use industry standard communication, message, and file-transfer protocols and will be able to ensure that the trade instructions sent to DTC are in the proper format.<sup>151</sup> BSTP states that, like many industry participants, its affiliates also currently maintain as part of their day-to-day operations multiple connections with a variety of pre- and post-trade services (including Omgeo) using FIX and other standardized protocols.<sup>152</sup> As BSTP correctly notes, even DTCC acknowledges that Omgeo currently interfaces with over 60 vendors, including a BSTP affiliate, on behalf of its customers.<sup>153</sup>

The Commission acknowledges that there may be externalities associated with a settlement infrastructure where multiple competing matching services link to DTC. Such externalities could manifest if, for example, a systems failure at BSTP reduces the ability of DTC to process transaction information received from Omgeo or SS&C. In such a scenario, BSTP may not fully internalize the costs of errors in its systems because a portion of these costs are imposed on its competitors. The Commission believes, however, that the interoperability conditions, along with the requirements in Regulation SCI for SCI entities to coordinate the

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<sup>150</sup> See *id.* at 13 (citing to SIFMA AMF for the point that additional service providers will permit firms to improve upon contingency strategies and disaster recovery models as well as allow firms to diversify their support model and mitigate risk by moving trade volume to other service providers if one is experiencing interruptions or outages).

<sup>151</sup> See *id.* at 15.

<sup>152</sup> See *id.*

<sup>153</sup> See *id.* at 12 n.37.

testing of business continuity and disaster recovery plans on an industry-wide basis,<sup>154</sup> help to mitigate the risk that one or more matching services with access to DTC could establish systems that significantly externalize the consequences of systems malfunctions to the national system for clearance and settlement.

In addition, DTCC notes two other benefits of its single-access model: (i) DTC would receive earlier warnings of potential problem transactions, which would reduce disruptions and improve the reliability and efficiency of the national clearance and settlement system; and (ii) exclusive reliance on Omgeo for access to DTC, NSCC, and the custodians/settlement agents would permit DTCC to facilitate future developments in the operational systems used to generate trade instructions for clearance and settlement, thereby reducing risk of system disruptions or system incompatibilities that result in trade failures.<sup>155</sup> The Commission does not see why these benefits cannot materialize if the BSTP and SS&C applications are approved. BSTP, for example, is proposing to include as part of its matching service other services that provide information to custodians and other stakeholders earlier in the settlement process than currently provided, which may also reduce the number of problem transactions. Similarly, approving the BSTP and SS&C applications does not prevent DTCC from facilitating future developments in the operational systems used to generate trade instructions for clearance and settlement. On the contrary, with three matching service providers, the number of entities that may be working to facilitate new developments in the generation of trade instructions will be increased.

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<sup>154</sup> See 17 CFR 242.1004(c). Application of Regulation SCI to exempt clearing agencies is addressed in Part III.B.8.

<sup>155</sup> As an example, DTCC cites a recent approved rule change in support of DTC's settlement matching initiative, intended to reduce uncertainty in the settlement of institutional transactions at DTC. See DTCC April letter at 14 n.44.

Second, DTCC states it is essential that only one entity issue control numbers because multiple issuers of control numbers would greatly increase the likelihood of settlement errors.<sup>156</sup> DTCC therefore recommends that regardless of where a trade is centrally matched, the broker be required to send a trade record and obtain a control number for that trade from Omgeo in a manner that facilitates the single access model, as the electronic confirmation and matching process is currently conducted.<sup>157</sup> DTCC further states that centralizing time-stamped trade records in this way allows DTC and settlement agents to more efficiently and effectively settle trades that have failed to settle on the scheduled date while allowing market participants to reconstruct trades or unwind positions as appropriate. DTCC notes that the time-stamped audit trail has allowed DTC and its affiliates to reconstruct trades after September 11, 2001, the bankruptcy of Lehman Brothers in 2008, and the “flash crash” in 2010, among other significant market events. DTCC also states that this centralized record allows DTC, market participants, and regulators to piece together events that cause market stress and has provided enormous benefit to regulators in examining trading history among investment managers and broker dealers.<sup>158</sup> DTCC states that, under a multiple access model, these efforts would be severely hampered, perhaps even lost.<sup>159</sup> It states that, because DTCC’s audit records are centralized, the industry can evaluate affirmation and settlement rates industry-wide because only a single entity has the records of all institutional trades from execution through settlement. Bifurcating this process, according to DTCC, would make it more difficult to monitor improvements and spot

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<sup>156</sup> See id. at 15.

<sup>157</sup> See id.

<sup>158</sup> See DTCC April letter at 7.

<sup>159</sup> See id. at 8.

trends in affirmation and settlement rates, including, in particular, spotting the points in transactions where failure is most likely to occur.<sup>160</sup>

BSTP acknowledges that, ideally, there should be one issuer of control numbers and that, because it is essential to the safe and sound settlement of securities transactions, it is the responsibility of DTC to provide control numbers as a registered clearing agency.<sup>161</sup> BSTP states that the creation of control numbers, the transmission of control numbers to the parties involved in settlement, and the transmission of settlement instructions to DTC are critical components of post-trade processing and, as such, are elements of the national clearance and settlement system that must be provided on a fair and non-discriminatory basis by DTC.<sup>162</sup>

BSTP explains that, contrary to DTCC's claim that a specific time for obtaining a control number should be incorporated into BSTP's application, incorporating a control number in the matching process is well understood. BSTP cites the Matching Release in explaining that the control number is obtained from DTC during the process of confirming the terms of a trade with the broker-dealer involved in the trade.<sup>163</sup> As mentioned above in Part III.B.2.iii, BSTP notes that DTC could ensure that control numbers generated by BSTP are distinguishable from those generated by Omgeo.<sup>164</sup> BSTP also notes that a control number is required to be obtained by

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<sup>160</sup> See id.

<sup>161</sup> See BSTP May letter at 14.

<sup>162</sup> See BSTP August letter at 5 (citing statements regarding the issuance of control numbers made in the Cornerstone Report at 21).

<sup>163</sup> See id. at 14 n.42 (citing 63 FR at 17944-45).

<sup>164</sup> See id. at 14 n.41.

qualified vendors of ETC services, and notes that FINRA Rule 11860 does not require the use of the Omgeo-centric existing infrastructure by qualified vendors.<sup>165</sup>

The Commission has previously addressed the concerns regarding issuance and management of control numbers above in Part III.B.2.iii, including DTCC's concerns regarding centralization of trade data. The Commission does not view the prospect of a multiple access model as being inconsistent with the ability to have a centralized source of control numbers. Consequently, the Commission finds the systemic risk concerns cited by DTCC on this matter to be unpersuasive.

Lastly, the Cornerstone Report raises concerns that, because of the potential increase in systemic risk resulting from the approval of multiple matching service providers, market participants' ability to comply with Regulation SCI may be impaired.<sup>166</sup> The Commission views this argument as speculative and unpersuasive. Neither DTCC nor the Cornerstone Report identify how a market participant, or even which market participant, might find it harder to comply with Regulation SCI in the wake of the Commission approving new matching service providers. Neither DTCC nor the Cornerstone Report estimate any costs that might result from such changes either. Further, the Commission notes that industry-wide testing required under

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<sup>165</sup> See *id.* at 14 n.40. BSTP also clarifies that it will be authorized under FINRA Rule 11860 to be utilized for the electronic confirmation and affirmation of all depository-eligible transactions if the Commission grants an exemption. See *id.* at 25–26. In the Matching Release, the Commission stated that, in the process of considering whether to grant an exemption, an entity would have to meet the requirements to become a qualified vendor under the relevant SRO rules because they are necessary elements in providing a matching service. See Matching Release, *supra* note 13, at 17947 n.27.

<sup>166</sup> See Cornerstone Report at 32–35, 36–37. The Commission notes that this particular issue raised in the Cornerstone Report is directed at whether BSTP and SS&C specifically can comply with Regulation SCI. Concerns regarding general compliance by exempt clearing agencies with Regulation SCI related are addressed in Part III.B.8.

Regulation SCI should not be negatively impacted by whether the number of participants in any particular market segment ebbs and flows from one year to the next. The Commission believes the benefit of removing a single point of dependency, as discussed above, is consistent with the public interest and the protection of investors and supports the approval of new matching service providers.

ii. Solvency of Applicants

DTCC raises concerns about how the sudden insolvency of either BSTP or SS&C might raise systemic risk concerns in the event that market participants, who had come to rely on the availability of BSTP and SS&C as matching service providers, were no longer able to use their matching services.<sup>167</sup> DTCC states that the benefits of the BSTP and SS&C applications may ultimately be fleeting because BSTP and SS&C are private companies that may become insolvent or choose to forego or discontinue providing matching services after a short time if providing such services does not prove to be profitable or otherwise advisable.<sup>168</sup> DTCC suggests that insolvency is more likely for BSTP and SS&C because they are for-profit companies, and notes that the potential insolvency of either of their parent or affiliate companies could raise the same concerns. DTCC implies that, as an industry-owned utility, Omgeo does not carry the same level of risk. DTCC states that if either BSTP or SS&C ceased to provide matching services after the industry had become reliant on it to perform such services, the likelihood of failed trades could increase and the industry may need to undergo an extensive reintegration period to onboard market participants. Accordingly, DTCC believes that BSTP,

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<sup>167</sup> See DTCC April letter at 17–18 (as to BSTP); DTCC May letter at 15 (as to SS&C).

<sup>168</sup> See id. at 12 n.37.

SS&C, and their parent and affiliate companies should each be required to provide additional assurances regarding insolvency.

BSTP responds that it has devoted substantial resources to developing its matching service, is committed to that matching service, and is adequately capitalized. In addition, BSTP states that, as part of obtaining an exemption from registration as a clearing agency, BSTP has agreed to provide the Commission annual audited financial statements, and states that no additional assurances regarding financial strength should be necessary.<sup>169</sup> Similarly, SS&C responds that DTCC's concerns are speculative and unfounded. SS&C notes that it is a public company and therefore publishes audited financial statements which are also supplied to the Commission. SS&C states that no further assurances regarding financial strength are necessary.<sup>170</sup>

With respect to the future potential insolvency of the applicants, their parents, and their affiliates, the Commission believes such speculation does not merit denial or modification of the applications at this time. DTCC provides no rationale for why, as for-profit entities, BSTP and SS&C, or their parent companies or affiliates, are more likely to become insolvent than Omgeo or DTCC. Indeed, the Commission notes that DTCC's own Cornerstone Report suggests that, in a market with multiple matching service providers, Omgeo may find itself no longer financially viable.<sup>171</sup> Should the prospect of insolvency of a matching service provider materialize, the

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<sup>169</sup> See BSTP May letter at 20.

<sup>170</sup> See SS&C letter at 4.

<sup>171</sup> See Cornerstone Report at 22.

Commission can consider modifying or revoking an exemption from registration under certain procedures, addressing the specific conditions as they arise.

Further, the Commission is mindful that, during an extended service outage, the failure of a single matching service provider could cause significant disruption to the financial markets. In this regard, denying the BSTP and SS&C applications would preserve such risk and leave it concentrated in a single entity because Omgeo is currently the only matching service provider for the U.S. equity markets. The Commission believes that approving the BSTP and SS&C applications could help mitigate this risk.

iii. Resiliency of Applicants

DTCC expressed concerns regarding whether BSTP and SS&C systems would have the capacity to handle the significant amount of potential order flow, particularly during the high volumes that can occur during times of market stress or volatility, noting that Omgeo has developed with its customers both direct proprietary links to existing systems as well as web-based linkages and interfaces hosted by third party order management systems and vendors.<sup>172</sup> DTCC states that the proprietary linkages can handle tremendous trading volumes, as has been demonstrated repeatedly in the past, including during the 2010 “flash crash.”<sup>173</sup>

The Commission is satisfied that both the BSTP and SS&C applications provide sufficient assurances regarding their proposed risk management framework. First, as SS&C notes in its comment letter, SS&C Canada and SSCNet have represented that they are staffed adequately with qualified and experienced industry veterans that have been in the post-trade

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<sup>172</sup> See DTCC May letter at 17; DTCC April letter at 22.

<sup>173</sup> See DTCC May letter at 17 & n.42.

services industry for decades and notes that it has long advocated for responsible growth when it comes to staffing numbers, facilities, and infrastructure. SS&C also represented that it has consistently applied stress and capacity disciplines during its history to ensure the soundness of its post-trade application.<sup>174</sup> Similarly, BSTP represented that it has planned for adequate systems capacity and conducts stress testing. It also represented that BSTP and its affiliates have a comprehensive business continuity management program to ensure a timely response to, and effective recovery from, unanticipated business interruptions that may affect facilities, technology, and/or people. BSTP represented that, to minimize business interruption events, BSTP will undertake continuous monitoring and identification of potential risks and take action designed to mitigate the impact of these risks.<sup>175</sup>

The Commission discusses concerns specific to BSTP and SS&C's operational risk management frameworks below in Part III.B.5. Concerns raised by DTCC in response to the cross-border nature of the SS&C application are addressed in Part III.B.5.i below as well.

iv. Volume Limits in the SS&C Application

DTCC notes that the SS&C application represents that SS&C will only match up to one percent of the U.S. aggregate daily volume of securities trades and would seek an amendment 180 days prior to exceeding that limit, which means that SS&C may have to refuse to provide matching services to some trades in some instances, which may create problems for market participants that are uncertain whether their trades would be accepted for matching by SS&C.<sup>176</sup>

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<sup>174</sup> See SS&C letter at 5.

<sup>175</sup> See BSTP May letter at 22.

<sup>176</sup> See DTCC May letter at 17 n.41.

The Commission is mindful of this concern, and requested an amendment, which SS&C submitted on November 9, 2015 to remove the representation regarding volume limits. The Commission agrees that volume limitations may create uncertainty as to whether SS&C's matching service is able to match trades, increasing the risk that a trade may fail in the event that SS&C has unexpectedly exceeded the volume limits represented in its application. Therefore, the Commission does not believe that volume limitations are necessary for the SS&C application to be consistent with the public interest, the protection of investors, and the purposes of Section 17A of the Exchange Act.

5. Operational Risk

Under Section 17A of the Exchange Act, applicants must demonstrate that they are so organized and have the capacity to be able to facilitate the prompt and accurate clearance and settlement of securities transactions. Questions of capacity have previously been addressed in Parts III.B.2.ii, in connection with facilitating access to DTC, and III.B.4.iii, in connection with questions about the applicants' resiliency. Nevertheless, several comments raised concerns related to particular operational risks, and the Commission considers such concerns below.

With respect to operational risk management, DTCC notes that its own regulated affiliates have each been subject to business continuity standards higher than those set forth in Regulation SCI.<sup>177</sup> DTCC states that BSTP, SS&C, and their parent companies should be held to the same standard. DTCC also states that the Commission should also hold the parents and affiliates of BSTP and SS&C to the same standards of internal controls, security, and business continuity as the Commission holds other critical participants in the national clearance and

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<sup>177</sup> See infra note 246.

settlement system to the extent those parents and affiliates are relied upon to perform matching services because that would best serve the public interest and the protection of investors.<sup>178</sup> In addition, because BSTP seeks to license from BLP the operations and systems to conduct its matching service, DTCC states that both BSTP and BLP should be subject to the full panoply of legal and regulatory requirements under Regulation SCI, and that BLP should be required to make available its books and records, as well as its operating systems, to inspection by the Commission upon request.<sup>179</sup> Similarly, because SS&C seeks to rely on SS&C Canada for the operations and systems to conduct central matching, DTCC states that both SS&C and SS&C Canada should be subject to the full panoply of legal and regulatory requirements under Regulation SCI and ARP.<sup>180</sup> DTCC notes that both BSTP and SS&C would have relatively small staffs to oversee their matching services.<sup>181</sup>

BSTP responds that it is staffed with an adequate number of qualified and experienced personnel to operate BSTP. BSTP notes that its staff includes industry veterans who know the marketplace and are well suited to operate BSTP and ensure that BSTP complies with all applicable regulatory standards, including stringent business continuity, information security, and capacity testing plans and procedures.<sup>182</sup> With respect to Regulation SCI, BSTP notes that DTCC's regulated affiliates (namely, DTC, NSCC, and FICC) are subject to high standards because they are registered clearing agencies and have been designated as systemically important

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<sup>178</sup> See DTCC May letter at 3; DTCC April letter at 7, 21–22.

<sup>179</sup> See DTCC June letter at 4–5; DTCC April letter at 21–22 & n.67.

<sup>180</sup> See DTCC September letter at 3; DTCC May letter at 17.

<sup>181</sup> See DTCC April letter at 21; DTCC May letter at 16–17.

<sup>182</sup> See BSTP May letter at 21.

under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. BSTP notes that Omgeo is not a registered clearing agency and has not been designated systemically important, and therefore the standards applicable to DTCC's registered clearing agency subsidiaries do not apply to Omgeo.<sup>183</sup>

SS&C responds that, if granted an exemption, all parts of the SSCNet matching service would be subject to Regulation SCI. SS&C states that there is no legal basis for Regulation SCI to apply to the broader SS&C complex, however, because those affiliates and subsidiaries are not within the scope of entities subject to Regulation SCI under the conditions proposed in the SS&C notice. SS&C further states that SSCNet will be subject to and intends to comply with all of the standards specified by the Commission that are applicable to exempt clearing agencies.<sup>184</sup> SS&C also adds that DTCC's proposed single access model would pose greater security and confidentiality risks than a multiple access model because transactions involving non-Omgeo clients would have to be routed through the existing Omgeo infrastructure, thereby exposing confidential information to a competitor (Omgeo) that otherwise is not a party to the transaction.<sup>185</sup>

The Commission addresses concerns specific to the cross-border nature of SS&C's operations below. More generally, the Commission notes that there has been a long history of parent and affiliate companies providing facilities management and operational support for clearing entities, and this has been accepted by the Commission in the past. For example, in

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<sup>183</sup> See id. at 25.

<sup>184</sup> See SS&C letter at 5.

<sup>185</sup> See SS&C letter at 4-5.

1972 the New York Stock Exchange and Amex founded the Securities Industry Automation Corporation (“SAIC”) to handle such services for their clearinghouses.<sup>186</sup> SAIC later became the facilities manager for NSCC, which is now a clearing agency within the DTCC complex. In this regard, BSTP’s staffing arrangements and reliance on affiliates are similar to Omgeo and the other registered clearing agencies within the DTCC complex. The Commission also believes that subjecting BSTP and SS&C to Regulation SCI pursuant to the conditions in this order addresses the concern about business continuity standards and is consistent with Regulation SCI’s approach to exempt clearing agencies subject to ARP. The Commission also believes that whether Regulation SCI should apply to such affiliates and/or parent companies is a function of the provisions and definitions in Regulation SCI considered and adopted by the Commission.

Further, as noted elsewhere in this order,<sup>187</sup> the Commission believes that BSTP and SS&C should be held to the same regulatory requirements as Omgeo because each entity is providing the same type of service. That the DTCC complex as a whole may be subject to heightened standards for, in this case, resiliency and business continuity under Section 17A of the Exchange Act and Regulation SCI stems from, among other things, its role as holding company for three registered clearing agencies that provide CCP and CSD services.<sup>188</sup> As previously mentioned and discussed further in Part III.B.8, BSTP and SS&C, like Omgeo, are exempt clearing agencies subject to the Commission’s ARP and therefore SCI entities under Regulation SCI. The Commission believes that the requirements under Regulation SCI are

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<sup>186</sup> See Bradford Nat’l Clearing Corp. v. SEC, 590 F.2d 1085, 1097 (D.C. Cir. 1978).

<sup>187</sup> See, e.g., supra notes 110–112 and accompanying text.

<sup>188</sup> See, e.g., supra note 65–66 and accompanying text.

sufficient to help ensure that BSTP and SS&C are held to high standards for internal controls, redundancy, security, and business continuity.

DTCC states that BLP's historic treatment of intellectual property raises concerns regarding BSTP's safeguards in this area, as well as in maintaining the privacy of users and the confidentiality of data within its databases. DTCC notes that BSTP plans to license its software, hardware, administrative, operational, and other support services from BLP, and therefore stated that the Commission should require extensive firewalls and other internal controls to prevent the misuse of clearing data obtained through BSTP's ETC and matching service.<sup>189</sup> BSTP responds that, in raising concerns about BSTP's ability to maintain privacy of users and confidentiality of data, DTCC cites to BLP's enhancement of access controls to prevent inappropriate access to BLP's client data. BSTP states that, if anything, these enhanced access controls provide added assurance that BSTP data will be held securely. BSTP notes that BLP is a preeminent data service provider, and that BLP and BSTP have information security policies and procedures in place that meet or exceed industry standards.<sup>190</sup>

The Commission has evaluated the aspects of the BSTP application relating to operational risk management and internal controls. DTCC's arguments made about the prospect of confidentiality or privacy breaches are speculative and unsubstantiated by any past conduct or previous violations. The BSTP application indicates that BSTP has planned for adequate systems capacity and that it conducts stress testing. The Commission notes that BSTP and its affiliates have a business continuity management program to ensure a timely response to, and

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<sup>189</sup> See DTCC April letter at 18.

<sup>190</sup> See BSTP May letter at 22.

effective recovery from, unanticipated business interruptions that may affect facilities, technology, and/or people. The Commission also notes that the BSTP application indicates BSTP staff includes industry veterans knowledgeable of the marketplace and well suited to operate BSTP.

As with BSTP, the Commission has reviewed the staffing, reliance on affiliates for operational systems, internal controls, and related aspects of the SS&C application. Again, DTCC's arguments made about the prospect of confidentiality or privacy breaches are speculative and unsubstantiated by any past conduct or previous violations, and SS&C has been providing local and centralized matching facilities and ETC services for twenty years.<sup>191</sup> SSCNet is currently operating as a real time and batch-based system, so its proposed functionality under the SS&C application is not purely hypothetical. Further, as mentioned above, requiring trade data from SS&C customers to pass through Omgeo in order to arrive at DTC, as contemplated by DTCC's suggested single access model, could create conditions more favorable for confidentiality breaches than if such data was not routed through a competitor.

In addition, as discussed above, BSTP and SS&C, as SCI entities, will be subject to Regulation SCI. For example, Rule 1001(b) of Regulation SCI requires an SCI entity to have policies and procedures reasonably designed to ensure that their SCI systems operate in a manner that complies with the Exchange Act and rule and regulations thereunder and the entity's rules and governing documents, as applicable.<sup>192</sup>

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<sup>191</sup> See SS&C letter at 4.

<sup>192</sup> See *id.* at 72437-38.

i. Cross-Border Aspects of the SS&C Application

DTCC notes that the SS&C application indicates all matching service activities will be performed by SS&C Canada. DTCC states that SS&C's reliance on a foreign subsidiary to perform critical functions distinguishes the SS&C application from the circumstances underlying, and the regulatory impact of, Omgeo's current exempt status, and raises concerns for the safety and soundness of the national clearance and settlement system.<sup>193</sup>

On a general level, DTCC states that the Commission must satisfy itself of the following:

(i) that the role of SS&C Canada would not weaken the regulatory framework applicable to SS&C's activities; and (ii) that the proposed framework in which SS&C is the regulated entity but SS&C Canada performs the actual matching function would not create a risk of disconnectedness or regulatory impairment with respect to the Commission's oversight of the national clearance and settlement system. In addition, DTCC states that the Commission should carefully scrutinize SS&C's undertakings with respect to operational, interoperability, and access matters, and its own ability to monitor the effects of SS&C's overall activities on the national system for clearance and settlement.<sup>194</sup>

On a more specific level, DTCC states several concerns relating to choice of law, jurisdiction, privacy of information, and timely access to records.<sup>195</sup> One concern is that the Commission should require SS&C to demonstrate that applicable Canadian employment law would not impede or impair SS&C's ability to perform the undertakings provided in the SS&C

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<sup>193</sup> See DTCC September letter at 3; DTCC May letter at 10.

<sup>194</sup> See DTCC May letter at 11.

<sup>195</sup> See DTCC September letter at 3.

application, including with respect to access to SS&C Canada employees.<sup>196</sup> DTCC also raises concerns with respect to conflicts between U.S. and Canadian privacy and securities laws and states that SS&C should be required to employ Connecticut counsel to offer its views on whether Connecticut law would interpret the Canadian privacy statutes to permit SS&C Canada to provide trade information to SS&C daily without concerns about being in violation of those statutes.<sup>197</sup> DTCC also states that SS&C needs to demonstrate that Canadian law applicable to the treatment and production of relevant data and client information would not impede or impair the production and provision of information required by regulators.<sup>198</sup>

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<sup>196</sup> See DTCC May letter at 12.

<sup>197</sup> See *id.* at 13. DTCC notes that the intercompany agreement between SS&C and SS&C Canada described in the SS&C application states that SS&C shall provide the Commission with access to information relating to SS&C Canada's matching system and electronic confirmation services, including all documents it receives from SS&C Canada. DTCC further notes that the SS&C application states that SS&C has confirmed with external counsel that implementation of the intercompany agreement would not violate the Canadian privacy statutes, which specifically are the Canadian Personal Information Protection and Electronic Document Act and the Ontario Business Records Protection Act. DTCC also states that, according to the SS&C application, because the intercompany agreement is governed by Connecticut law and SS&C's external counsel are not qualified to practice in Connecticut, SS&C has only assumed that Connecticut courts would interpret the intercompany agreement the same as the applicable Canadian courts. DTCC explains that if SS&C's external counsel were incorrect in their assumption, a Canadian customer might be able to sue SS&C to prevent SS&C Canada from providing SS&C with daily trade information, including confirmations, which would make it difficult for SS&C to oversee SS&C Canada's operations and may prevent the Commission from having ready access to trade records. See *id.*

<sup>198</sup> See *id.* DTCC says that, given the importance of this issue, the opinion of qualified legal counsel concerning whether local Ontario privacy and business record laws would be breached by the intercompany agreement seems insufficient and further due diligence is warranted. In addition, DTCC says that SS&C should address whether other Canadian law could result in the unanticipated disclosure of customer information or could provide the basis for a Canadian customer asserting that data held by SS&C Canada should not be provided to SS&C or to regulators. See *id.*

Further, DTCC states that it understands that certain activities of SS&C Canada are regulated by the Ontario Securities Commission (“OSC”) and the Autorité des marchés financiers (“AMF”), and therefore SS&C should demonstrate that its reliance on SS&C Canada for the purposes contemplated in the SS&C application are not in conflict or inconsistent with existing requirements under applicable Canadian provincial securities laws.<sup>199</sup> DTCC also notes that SS&C’s Form 10-K indicates that SS&C has recognized that a substantial portion of its operations are conducted outside of the United States and that it is subject to a variety of related risks, including the potential difficulty to enforce third-party contractual obligations and intellectual property rights. DTCC states that the Commission should therefore require further due diligence by SS&C in this area.<sup>200</sup>

In addition, DTCC states that the SS&C application does not discuss any due diligence performed by SS&C with respect to SS&C Canada and SS&C Canada’s capabilities in supporting SS&C or its abilities to discharge the services and obligations contemplated in the intercompany agreement.<sup>201</sup> In this regard, DTCC cites the IOSCO Principles on Outsourcing of Financial Services for Market Intermediaries (2005) as noting various risks related to cross-border outsourcing, for which financial institutions should conduct enhanced due diligence.<sup>202</sup>

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<sup>199</sup> See id.

<sup>200</sup> See id. at 14.

<sup>201</sup> See id. at 11.

<sup>202</sup> See id. at 11–12. DTCC notes, for instance, that when considering cross-border outsourcing, the outsourcing firm should conduct enhanced due diligence that focuses on special compliance risks, including the ability to effectively monitor the foreign service provider, the ability to maintain the confidentiality of firm and customer information, and the ability to execute contingency plans and exit strategies where the service is being performed on a cross-border basis. See id. at 11. DTCC states that special outsourcing risks also include individual

DTCC states that the Commission should require SS&C to demonstrate that it has conducted such enhanced due diligence, including the written documentation of the results of such due diligence.<sup>203</sup>

Finally, DTCC notes that, pursuant to the SS&C application, SS&C Canada will operate the matching and ETC service on behalf of SS&C. DTCC believes operational support may be provided to an exempt clearing agency by a non-U.S. affiliate but states that the SS&C application raises issues related to such support. DTCC states, for example, that pursuant to its application, the policies and procedures of SS&C Canada are overseen by its officers and directors and subject to control by SS&C Holdings. DTCC believes that SS&C Canada's policies and operations related to matching should be overseen by SS&C itself.<sup>204</sup>

DTCC notes, in particular, the integral role played by SS&C Canada suggests that extra scrutiny be placed on cross-border issues to the extent they could delay or impede the proper functionality of trade matching and settlement, as previously noted above.<sup>205</sup> Specifically, DTCC says that SS&C's plan to rely on SS&C Canada and other off-shore affiliates within the SS&C complex for operational performance of its matching and ETC service, along with other related services, raises concerns about SS&C's ability to appropriately protect its intellectual

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firm concentration risk and the associated exit strategy risk (e.g., over-reliance on the outsourced provider and a lack of relevant skills within SS&C itself), that concentration risk includes the potential sale of SS&C Canada by SS&C, and that access risk includes both the risk of timely access by SS&C and its auditors and regulators to data, records, or assets and conversely risk of access by SS&C Canada employees to SS&C client account data, records, and assets. See id. at 11–12.

<sup>203</sup> See id. at 12.

<sup>204</sup> See id. at 14.

<sup>205</sup> See id. at 3.

property and to maintain the privacy of users and confidentiality of data within its databases. DTCC says that the Commission should require extensive firewalls and other internal controls to prevent the misuse of clearing data obtained through SS&C's electronic confirmation and matching service, including the misuse of such data in providing other services within the SS&C complex.<sup>206</sup>

SS&C responds that the various assertions described above regarding the oversight of SS&C Canada by SS&C are unfounded and that SS&C has complete oversight of and visibility into the operations of SSCNet. SS&C further states that SS&C Canada and the SSCNet application fall under the scrutiny and review of a number of SS&C's U.S.-based executive committees providing direct oversight, including its Operating Committee, its Security Committee, and a U.S.-based internal audit department that reports to the U.S.-based Audit Committee. It also states that the SSCNet division reports to the U.S.-based Senior Vice President, Institutional and Investment Management; its development division reports to the U.S.-based Senior Vice President, Chief Development Officer; and its Information Technology Services division reports to the U.S.-based Chief Technology Officer. SS&C also notes that Omgeo operates in many jurisdictions outside the United States, including Canada, on the same basis.<sup>207</sup>

SS&C also responds that DTCC incorrectly asserts that some or all applications offered by SS&C are comingled with each other and that intellectual property, privacy of users, and confidentiality of data is lacking. SS&C states that it is a leading global data service provider

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<sup>206</sup> See id at 15.

<sup>207</sup> See SS&C letter at 4.

that deploys information security policies, procedures, and controls that meet or exceed industry standards and that SS&C has never experienced a breach of security or privacy.

The Commission is satisfied that the cross-border aspects of the SS&C application have been sufficiently addressed without requiring denial or modification of the application. First, as described in Part II.B, the SS&C application includes a series of representations designed to ensure that the Commission can fulfill its regulatory obligations with respect to SS&C. SS&C is a U.S. person incorporated in Delaware with a Connecticut business registration that dates back to 1996. According to its application, SS&C will enter into an intercompany agreement with SS&C Canada governing the availability of information related to matching services. As a subsidiary of SS&C, SS&C Canada will be subject to the control of its parent company. Further, as described in the SS&C letter, SS&C's executive committees such as the Operating Committee and the Security Committee provide direct oversight of SSCNet.<sup>208</sup> The Commission believes that control of SS&C Canada by a U.S. parent and the contractual arrangements outlined in SS&C's application are sufficient to allow the Commission to exercise oversight of SS&C consistent with the Exchange Act.

Second, the Commission has entered into a memorandum of understanding concerning consultation, cooperation, and the exchange of information related to the supervision of cross-border regulated entities with the AMF and the OSC. The MOU notes that it is intended to express each authority's willingness to cooperate with each other in the interest of fulfilling their

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<sup>208</sup> See SS&C letter at 4.

respective regulatory mandates, particularly in the areas of investor protection, fostering the integrity of and maintaining confidence in the capital markets, and reducing systemic risk.<sup>209</sup>

More generally, as previously discussed, the Commission is familiar with arrangements whereby a registered entity contracts out functions to other entities that may or may not be directly regulated by the Commission, and may or may not be located within the U.S. In the absence of a concrete obstacle—for example, a specific foreign statute blocking access currently in effect, or a history of instances of non-compliance by an entity—DTCC’s arguments about cross-border risks depend on purely speculative concerns. For example, such prospects are not grounded in a particular fact pattern identified by DTCC or other commenters, and do not demonstrate that SS&C is hindered in its ability to comply with the conditions below.

Finally, we note that as with the Omgeo order, this order includes provisions for modification if necessary or appropriate in the public interest, the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.<sup>210</sup> The Commission may also limit, suspend, or revoke this exemption if it finds that SS&C has violated or is unable to comply with any of the provisions set forth in this order if such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.<sup>211</sup> Thus, should concerns about SS&C arise in the future, the Commission retains

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<sup>209</sup> See Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to the Supervision of Cross-Border Regulated Entities, Sept. 2011, available at [http://www.sec.gov/about/offices/oia/oia\\_bilateral/canada\\_regcoop.pdf](http://www.sec.gov/about/offices/oia/oia_bilateral/canada_regcoop.pdf).

<sup>210</sup> See *infra* Parts IV.A.3 (for BSTP) and IV.B.3 (for SS&C).

<sup>211</sup> See *id.*

sufficient tools to ensure that SS&C acts consistent with the public interest, the protection of investors, and the purposes of Section 17A of the Exchange Act.

6. Governance of BSTP

DTCC states that the composition of BSTP's board of directors as described in the BSTP application raises concerns about the overlap between BSTP and its for-profit parent BLP because only one of the board's four members is an industry representative, which could compromise BSTP's independence from BLP and the extent to which BSTP is capable of playing a neutral role as an industry utility.<sup>212</sup>

According to BSTP, while BSTP's parent, BLP, will provide BSTP with software, hardware, administrative, operational, and other support services, BSTP has established a separate board of directors to oversee its operations and will hold ultimate legal responsibility over its operations.<sup>213</sup> BSTP states that its governance arrangements are designed to help ensure that BSTP will be operated in a manner that is consistent with the public interest and the protection of investors by establishing specific governance principles and fitness standards for qualification of each member of the board of directors.<sup>214</sup> BSTP also states that it intends to establish an advisory board consisting of industry members and users of BSTP, including representatives from broker-dealers, investment managers, and custodians, and that it intends to continue engaging with the securities industry and market participants as a further means of

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<sup>212</sup> See DTCC April letter at 17.

<sup>213</sup> See BSTP May letter at 20.

<sup>214</sup> See id.

ensuring that BSTP operates in a manner that is consistent with the public interest and the protection of investors.<sup>215</sup>

The Commission is mindful of DTCC's concerns but disagrees. As BSTP notes, DTCC provides no support from the Omgeo order that matching service providers be non-profit entities or that for-profit entities be subject to special controls by virtue of that status.<sup>216</sup> Omgeo itself was 49.9-percent owned by a for-profit entity at its formation.<sup>217</sup> The Commission recognizes that, as originally conceived, five of nine voting managers on Omgeo's board of managers were industry representatives,<sup>218</sup> which reflects a higher ratio of industry representatives than BSTP's board of directors. The Commission also notes that BSTP has represented that it will make efforts to incorporate industry representatives into BSTP's decision-making process. Specifically, the Commission believes that the advisory board would provide useful industry input into the decisions made by BSTP's board of directors. In addition, the Commission believes that BSTP's proposed industry working group will help ensure that the users of BSTP's matching service will have significant input into BSTP's service offerings and operations. Further, as with the Omgeo order and as noted above with respect to SS&C, this order includes provisions for modification if necessary or appropriate in the public interest, the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. The Commission

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<sup>215</sup> See id. at 20–21. Specifically, BSTP stated that, in designing BSTP's matching service, BSTP met with over 30 investment managers, created and obtained input from two working groups (one comprised of representatives from seven industry-leading custodians and one comprised of representatives from fifteen prominent broker-dealers). See id. at 20 n.62.

<sup>216</sup> See id. at 19.

<sup>217</sup> See Omgeo order, supra note 37, at 20495.

<sup>218</sup> See id.

may also limit, suspend, or revoke this exemption if it finds that BSTP has violated or is unable to comply with any of the provisions set forth in this order if such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. Thus, should concerns about BSTP arise in the future, the Commission retains sufficient tools to ensure that BSTP acts consistent with the public interest, the protection of investors, and the purposes of Section 17A of the Exchange Act.

DTCC additionally states that BSTP should be subject to stricter corporate governance controls similar to those imposed on Omgeo, and that BSTP's board should be required to maintain fair representation of its ETC and matching service customers.<sup>219</sup> The Commission disagrees and continues to believe that an entity such as BSTP that limits its clearing agency functions only to providing matching services need not be subject to the full panoply of clearing agency regulation.<sup>220</sup> This includes the requirement that the rules of the clearing agency assure a fair representation of its shareholders and participants in the selection of its directors.<sup>221</sup>

In response to DTCC's suggestion that Omgeo is subject to heightened governance requirements, the Commission believes it is appropriate to highlight several reasons for the various legal and other regulatory requirements to which the entities within the DTCC complex are subject, as follows. First, Omgeo is an exempt clearing agency subject to the terms and conditions of the Omgeo order. Second, DTC, by contrast, is a registered clearing agency subject to the full panoply of clearing agency regulation. Accordingly, when the Commission

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<sup>219</sup> See DTCC April letter at 17; Cornerstone Report at 29.

<sup>220</sup> See Matching Release, supra note 13, at 17947.

<sup>221</sup> See 15 U.S.C. 78q-1(b)(3)(C).

approved transfer of the TradeSuite ID system from DTC to Omgeo, it highlighted the statutory requirement that DTC provide equitable allocation of dues, fees, and other charges among its participants and refrain from imposing any burden on competition not necessary or appropriate in furtherance of the purposes of Section 17A of the Exchange Act.<sup>222</sup> These requirements are obligations of DTC, not Omgeo, and the Commission finds no basis for imposing obligations on BSTP and SS&C that have not been imposed on Omgeo.

7. Interoperability Among Matching Service Providers

i. Sufficiency of the Interoperability Conditions

Several commenters expressed views on the need for interoperability to ensure that a market structure with multiple matching service providers can facilitate the anticipated benefits described above. Specifically, four commenters emphasized the importance of facilitating interoperability between matching services. Two commenters stated that interoperability is vital to ensure that industry participants may choose their service providers free of any dependency and to support use by the full spectrum of potential users.<sup>223</sup> Another similarly stated that interoperability must be mandatory given the number of institutions active in this space while also noting that it may result in increased implementation costs to current and future matching services.<sup>224</sup> A fourth stated that, in its experience connecting to securities and derivatives clearing and settlement services globally, fair and open approaches have been valuable in encouraging continued investments by market participants and vendors, reinforcing the cycle of

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<sup>222</sup> See Omgeo order, supra note 37, at 20498 n.39.

<sup>223</sup> See Citi at 2; Fidessa.

<sup>224</sup> See Northern Trust.

innovation and meaningful cost reduction in global markets.<sup>225</sup> Two commenters further stated that the conditions proposed in the BSTP notice, which are the same as those proposed in the SS&C notice (and substantially the same as those contained in the Omgeo order),<sup>226</sup> were appropriate and adequate to facilitate interoperability and regulatory oversight.<sup>227</sup>

The Commission agrees that interoperability among matching service providers is critical to facilitating the establishment of linked and coordinated facilities for the clearance and settlement of securities transactions. In 2001, the Commission issued the Omgeo order mindful of concerns about interoperability. Accordingly, the Omgeo order included interoperability conditions designed to address concerns that, as the sole provider of matching services, Omgeo could improperly gain a monopoly in post-trade processing.<sup>228</sup> The interoperability conditions were designed to address these competition concerns and help ensure that Omgeo's exemption was consistent with the public interest, the protection of investors, and the purposes of Section 17A of the Exchange Act.<sup>229</sup> In particular, the Commission notes that the conditions set forth in the Omgeo order help facilitate the establishment of linked and coordinated facilities for the clearance and settlement of securities transactions, ensure choice among service providers, reduce costs to the users of matching service providers, and facilitate the entry of new matching service providers that might encourage innovation in the provision of matching services.

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<sup>225</sup> See Traiana.

<sup>226</sup> See generally Omgeo order, *supra* note 37.

<sup>227</sup> See SIFMA AMF at 1–3; Northern Trust.

<sup>228</sup> See Omgeo order, *supra* note 37, at 20496–97, 20498.

<sup>229</sup> See *id.* at 20498.

The Commission is satisfied that the BSTP and SS&C applications, which include substantially the same interoperability provisions as those set forth in the Omgeo order, will continue to facilitate these same goals. The Commission notes that both BSTP and SS&C expressed support for interoperability in their comment letters,<sup>230</sup> and that BSTP and SS&C also state that their applications will promote linkages and standardization, consistent with Section 17A(a)(1)(D) of the Exchange Act.<sup>231</sup> Specifically, SS&C states that it has a long history of linking with upstream accounting and order management systems used by institutional customers, service bureaus used by broker-dealers, and direct linkages into custodian platforms for those banks directly on its platform. It has also created interfaces with services that are seen as competitors such as SWIFT, SCRL, FX matching platforms, and vendors offering local matching engines. SS&C states it was also a charter member of ISITC North America (then the Financial Models Company) and that the promotion of standards and interoperability has long been a cornerstone of the company's philosophy.<sup>232</sup> Similarly, BSTP states that it will use industry standard communication protocols (e.g., TCP/IP, SNA) and message and file transfer protocols (e.g., FIX, WebSphere MQ), as well as support the FIX global post-trade processing guidelines. BSTP states that, as a result, it will be able to accept a market participant's preferred

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<sup>230</sup> See BSTP May letter at 4 (citing interoperability as one way in which the BSTP application promotes standards and linkages consistent with Section 17A of the Exchange Act); SS&C letter at 3 (stating that the promotion of uniform standards and interoperability have long been cornerstones of SS&C's company philosophy).

<sup>231</sup> See BSTP May letter at 4; SS&C letter at 2-3; see also 15 U.S.C. 78q-1(a)(1)(D).

<sup>232</sup> See SS&C letter at 3.

means of sending and receiving data, thereby minimizing the development cost needed to use BSTP's matching service.<sup>233</sup>

ii. Timeframes for Building and Operating Interfaces

DTCC states that the timeframes for building and operating interfaces, as set forth in the Omgeo order and included for BSTP and SS&C as part of this order, do not take into account the amount and complexity of the work that would need to be done to accommodate BSTP and/or SS&C's entry into the market structure for matching services and likely would be insufficient to enable the operational accuracy and reliability for the proper operation of an interface.<sup>234</sup> DTCC states that it would need to analyze requirements for and provide interoperability specifications to BSTP and/or SS&C to facilitate the formation of an interface, but such specifications cannot be determined until a functioning interface has been designed, developed, and tested.<sup>235</sup> DTCC further states that because functionality related to central matching interoperability does not currently exist within Omgeo or elsewhere within DTCC, DTCC would need to analyze its existing systems to ensure those systems, processes, and workflows would not be compromised by connecting to BSTP and/or SS&C.<sup>236</sup> DTCC indicates that the functionality to be considered would include, among others, (i) matching rules, (ii) reconciliation routines, (iii) exception management, (iv) control number assignments, and (v) account matter file requirements.<sup>237</sup>

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<sup>233</sup> See BSTP May letter at 4.

<sup>234</sup> See DTCC September letter at 2; DTCC June letter at 4; DTCC April letter at 15.

<sup>235</sup> See DTCC April letter at 15.

<sup>236</sup> See *id.* at 15–16.

<sup>237</sup> See *id.* at 16.

DTCC further states that because it does not know the nature of the BSTP and/or SS&C systems, if any, and whether or on what terms BSTP and/or SS&C might be eligible for an exemption from the Commission, it would be unreasonable to expect DTCC to devote resources to such issues until it has sufficient certainty about the nature of the interfaces that would need to be developed, if any.<sup>238</sup> DTCC also notes that additional time would also be needed if multiple matching service providers are simultaneously developing interfaces with each other, adding another layer of complexity that would need to be addressed in a risk-mitigating manner.<sup>239</sup>

BSTP responds that there is no justification to delay interoperability of Omgeo with other matching services. BSTP notes that, in the fourteen years since the Commission issued the Omgeo order, neither DTCC nor Omgeo has raised any concerns regarding the terms of that exemption. BSTP notes that the need for DTCC and its subsidiaries to devote resources to comply with the conditions in the Omgeo order is not a valid reason to modify the provisions found in the Omgeo order.<sup>240</sup> Further, BSTP notes that technological improvements since 2001 have increased the ease of establishing safe and secure communication links, suggesting that technological developments do not support modifying or extending the timeframes in the Omgeo order.<sup>241</sup>

SS&C acknowledges that there could be other appropriate timeframes for building and operating interfaces, and SS&C also states that the interoperability conditions contained within the Omgeo order already provide the means for extending those timeframes. SS&C further

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<sup>238</sup> See DTCC June letter at 4; DTCC May letter at 10; DTCC April letter at 15–16.

<sup>239</sup> See DTCC May letter at 10.

<sup>240</sup> See BSTP May letter at 17–18; BSTP August letter at 6.

<sup>241</sup> See BSTP May letter at 11.

states that the conditions proposed in the SS&C notice (the same as those contained in the Omgeo order) provide the appropriate mechanisms to allow parties to extend the timeframes, and accordingly SS&C sees no issue with the conditions proposed in the SS&C notice as they relate to timeframes for building and operating interfaces.<sup>242</sup> The Commission agrees with SS&C's observations inasmuch as interoperability condition (6), which appears in the Omgeo order and is applied to BSTP and SS&C below,<sup>243</sup> gives each matching service provider the flexibility to negotiate and determine appropriate timeframes beyond what the orders prescribe, as well as specified channels for appropriate resolution of disputes in certain instances.

Further, the Commission is mindful that Omgeo, BSTP, and SS&C will need time to develop the appropriate interfaces to ensure that their systems are interoperable consistent with the conditions set forth in the Omgeo order and this order below. The Commission agrees with SS&C that, while other timeframes may also be appropriate to build and operate interfaces, the interoperability conditions provide a mechanism for extending time on which the parties must agree, mitigating the concerns raised by DTCC. Indeed, the conditions help ensure that no one party can unnecessarily delay the process of building and operating interfaces for interoperability. In that regard, to the extent that DTCC was hesitant to devote resources to building and operating interfaces with other matching service providers because of questions as to whether and on what terms BSTP and SS&C would be eligible for an exemption to provide matching services, those questions are fully resolved in this order.

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<sup>242</sup> See SS&C letter at 4.

<sup>243</sup> See Omgeo order, supra note 37, at 20499; infra Parts IV.A.2.ii (for BSTP) and IV.B.2.ii (for SS&C).

8. Application of Regulation SCI to Exempt Clearing Agencies

DTCC requests that the Commission clarify whether and to what extent Regulation SCI has superseded reporting requirements for system outages and other events in the Omgeo order. Specifically, DTCC notes that Rule 1003(a) of Regulation SCI requires SCI entities to report material system changes, including submitting to the Commission a report within thirty calendar days after the end of each calendar quarter describing completed, ongoing, and planned material changes to SCI systems and the security of indirect SCI systems.<sup>244</sup> DTCC requests clarification of the relationship between this requirement and the requirement in operational condition (4) of the Omgeo order requiring Omgeo to provide twenty-days advance notice of material system changes to the Commission.<sup>245</sup>

On November 19, 2014, the Commission adopted Regulation SCI, which requires SCI entities to comply with requirements for policies and procedures with respect to their automated systems that support the performance of their regulated activities.<sup>246</sup> Regulation SCI became effective on February 3, 2015, and, with some exceptions, the compliance date was November 3, 2015.<sup>247</sup> In relevant part, Rule 1000 of Regulation SCI defines an SCI entity to include, among

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<sup>244</sup> Rule 1003(a)(1) requires an SCI entity to provide quarterly reports to the Commission, describing completed, ongoing, and planned material systems changes to its SCI systems and the security of indirect SCI systems, during the prior, current, and subsequent calendar quarters. Rule 1003(a)(1) also requires an SCI entity to establish reasonable written criteria for identifying a change to its SCI systems and the security of its indirect SCI systems as material.

In addition Rule 1003(a)(2) requires an SCI entity to promptly submit a supplemental report to notify the Commission of a material error in or material omission from a previously submitted report. See 17 CFR 242.1003.

<sup>245</sup> See id. at 17–18 & n.43; DTCC April letter at 22 & n.69.

<sup>246</sup> See Regulation SCI, supra note 70, at 72271.

<sup>247</sup> See id. at 72366.

other things, a registered clearing agency and an exempt clearing agency subject to ARP.<sup>248</sup> In particular, the term “exempt clearing agency subject to ARP” includes an entity that has received from the Commission an exemption from registration as a clearing agency under Section 17A of the Exchange Act, and whose exemption contains conditions that relate to the Commission’s ARP Policies, or any Commission regulation that supersedes or replaces such policies.<sup>249</sup> As set forth below, operational condition (1) to this order requires an audit report that addresses all areas discussed in ARP.<sup>250</sup> Accordingly, BSTP and SS&C are each an exempt clearing agency subject to ARP and therefore SCI entities subject to Regulation SCI. Because the Omgeo order contains the same condition,<sup>251</sup> it also is an exempt clearing agency subject to ARP and therefore an SCI entity subject to Regulation SCI.

In response to DTCC’s comment, the Commission notes that operational condition (4) was not a component of the ARP policy statements and therefore has not been superseded by Regulation SCI. Operational condition (4) ensures that the Commission receives 20-days advance notice of systems changes, which the Commission believes is necessary for matching service providers in light of the potential for linkages between matching service providers and the corresponding need for matching service providers to maintain interoperability pursuant to the interoperability conditions of the Omgeo order and this order.<sup>252</sup> Because the ARP policy statements did not explicitly contemplate advance notice of material systems changes, the

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<sup>248</sup> See Regulation SCI, supra note 70, at 72437.

<sup>249</sup> See id. at 72271.

<sup>250</sup> See infra Part IV.A.2.i (for BSTP) and Part IV.B.2.i (for SS&C).

<sup>251</sup> See Omgeo order, supra note 37, at 20498.

<sup>252</sup> See id.

requirement in operational condition (4) has not been superseded. In light of the similarity between the requirements in operational condition (4) and Rule 1003(a) of Regulation SCI, however, if any matching service provider believes that operational condition (4) should be modified or removed, the proper mechanism for modifying the condition is to file an amendment to the matching service provider's Form CA-1. The Commission notes that operational condition (4) is applied to both BSTP and SS&C below.<sup>253</sup>

In addition, because Regulation SCI has superseded the requirements in ARP, the Commission is providing clarification as to the requirements in operational conditions (1) and (2), which appear in the Omgeo order and are applied to BSTP and SS&C below.<sup>254</sup> Operational condition (1) states that before beginning the commercial operation of its matching service, an exempt clearing agency shall provide the Commission with an audit report that addresses all the areas discussed in the Commission's ARP. Operational condition (2) states, in relevant part, that an exempt clearing agency shall provide the Commission with annual reports and any associated field work prepared by competent, independent audit personnel that are generated in accordance with the annual risk assessment of the areas set forth in ARP and that an exempt clearing agency shall provide the Commission (beginning in its first year of operation) with annual audited financial statements prepared by competent independent audit personnel. The Commission finds that Rule 1003(b) of Regulation SCI has superseded these requirements.<sup>255</sup> Accordingly,

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<sup>253</sup> See infra Parts IV.A.2.i (for BSTP) and IV.B.2.i (for SS&C).

<sup>254</sup> See id.; Omgeo order, supra note 37, at 20498.

<sup>255</sup> See Regulation SCI, supra note 70, at 72439. Rule 1003(b)(1) of Regulation SCI requires an SCI entity to conduct an "SCI review" of the SCI entity's compliance with Regulation SCI not less than once per calendar year. An SCI review must contain (i) a risk assessment with respect to an SCI entity's SCI systems and indirect SCI systems, and (ii) an assessment of

pursuant to operational condition (1), BSTP and SS&C are required to submit an annual SCI review prior to beginning the commercial operation of their matching services. Pursuant to operational condition (2), Omgeo, BSTP, and SS&C, as SCI entities, are each required to submit an annual SCI review each calendar year consistent with Regulation SCI.

IV. Evaluation of the Applications

A. BSTP

In evaluating the BSTP application, the Commission has been guided by the requirements of Section 17A of the Exchange Act. Among other factors, the Commission has considered BSTP's risk management procedures, operational capacity and safeguards, organizational structure, and ability to operate in a manner that will satisfy the fundamental goals of Section 17A. The Commission has also carefully considered the comments received in response to the BSTP application, as discussed above. The Commission believes that the BSTP application supports the establishment of linked and coordinated facilities for the clearance and settlement of securities transactions.

Accordingly, for the reasons discussed throughout this order, the Commission finds that the BSTP application, including the terms and conditions set forth in the application and reproduced below, is consistent with the public interest, the protection of investors, and the

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internal control design and effectiveness of such systems to include logical and physical security controls, development processes, and information technology governance, consistent with industry standards.

Pursuant to Rule 1003(b)(2), an SCI entity must submit a report of the SCI review to senior management of the SCI entity for review no more than 30 calendar days after completion of such a review. Moreover, under Rule 1003(b)(3), an SCI entity must submit to the Commission, and to the board of directors of the SCI entity or the equivalent of such board, a report of the SCI review and any response by senior management within 60 calendar days after its submission to senior management.

purposes of Section 17A of the Exchange Act, and that BSTP is so organized and has the capacity to be able to facilitate prompt and accurate matching services.

Below are the terms and conditions of BSTP's exemption.

1. Scope of Exemption

This order grants BSTP an exemption from registration as a clearing agency under Section 17A of the Exchange Act to provide an ETC and matching service. The exemption is granted subject to conditions that the Commission believes are necessary and appropriate in light of the statutory requirements of Section 17A.<sup>256</sup> This order and the conditions and limitations contained in it are consistent with the Commission's statement in the Matching Release that an entity that limits its clearing agency functions to providing matching services does not have to be subject to the full range of clearing agency regulation.

2. Conditions of Exemption

The Commission is including specific conditions to this exemption designed to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions and the establishment of linked and coordinated facilities for the clearance and settlement of securities transactions. The conditions are designed to promote competition, transparency, consistency, and interoperability in the market for matching services.

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<sup>256</sup> The Commission is granting BSTP an exemption from clearing agency registration, so it will not be considered a self-regulatory organization under Section 3(a)(26) and therefore will not be required to file rule changes in accordance with Section 19(b) of the Exchange Act. The Commission is also not imposing a rule change filing requirement as a condition of the exemption.

i. Operational Conditions

(1) Before beginning the commercial operation of its matching service, BSTP shall provide the Commission with an audit report that addresses all the areas discussed in the Commission's Automation Review Policies ("ARP").<sup>257</sup>

(2) BSTP shall provide the Commission with annual reports and any associated field work prepared by competent, independent audit personnel that are generated in accordance with the annual risk assessment of the areas set forth in the ARP. BSTP shall provide the Commission (beginning in its first year of operation) with annual audited financial statements prepared by competent independent audit personnel.

(3) BSTP shall report all significant systems outages to the Commission. If it appears that the outage may extend for thirty minutes or longer, BSTP shall report the systems outage immediately. If it appears that the outage will be resolved in less than thirty minutes, BSTP shall report the systems outage within a reasonable time after the outage has been resolved.

(4) BSTP shall provide the Commission with 20 business days advance notice of any material changes that BSTP makes to the matching service or ETC service. These changes will not require the Commission's approval before they are implemented.

(5) BSTP shall respond and require its service providers (including BLP) to respond to requests from the Commission for additional information relating to the matching service and ETC service, and provide access to the Commission to conduct on-site inspections of all

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<sup>257</sup> See Exchange Act Release Nos. 27445 (Nov. 16, 1989), 54 FR 48703 (Nov. 24, 1989) ("ARP I"), and 29185 (May 9, 1991), 56 FR 22490 (May 15, 1991) ("ARP II"); see also Memorandum from the Securities and Exchange Commission Division of Market Regulation to SROs and NASDAQ (June 1, 2001) ("Guidance for Systems Outages and System Change Notifications"), available at <http://www.sec.gov/divisions/marketreg/sro-guidance-for-systems-outage-06-01-2001.pdf>.

facilities (including automated systems and systems environment), records, and personnel related to the matching service and the ETC service. The requests for information shall be made and the inspections shall be conducted solely for the purpose of reviewing the matching service's and the ETC service's operations and compliance with the federal securities laws and the terms and conditions in any exemptive order issued by the Commission with respect to BSTP's matching service and the ETC service.

(6) BSTP shall supply the Commission or its designee with periodic reports regarding the affirmation rates for institutional transactions effected by institutional investors that utilize its matching service and ETC service.

(7) BSTP shall preserve a copy or record of all trade details, allocation instructions, central trade matching results, reports and notices sent to customers, service agreements, reports regarding affirmation rates that are sent to the Commission or its designee, and any complaint received from a customer, all of which pertain to the operation of its matching service and ETC service. BSTP shall retain these records for a period of not less than five years, the first two years in an easily accessible place.

(8) BSTP shall not perform any clearing agency function (such as net settlement, maintaining a balance of open positions between buyers and sellers, or marking securities to the market) other than as permitted in an exemption issued by the Commission.

(9) Before beginning the commercial operation of its matching service, BSTP shall provide the Commission with copies of the service agreement between BLP and BSTP and shall notify the Commission of any material changes to the service agreement.

ii. Interoperability Conditions

(1) BSTP shall develop, in a timely and efficient manner, fair and reasonable linkages between BSTP's matching service and other matching services that are registered with the Commission or that receive or have received from the Commission an exemption from clearing agency registration that, at a minimum, allow parties to trades that are processed through one or more matching services to communicate through one or more appropriate effective interfaces with other matching services.

(2) BSTP shall devise and develop interfaces with other matching services that enable end-user clients or any service that represents end-user clients to BSTP ("end-user representative") to gain a single point of access to BSTP and other matching services. Such interfaces must link with each other matching service so that an end-user client of one matching service can communicate with all end-user clients of all matching services, regardless of which matching service completes trade matching prior to settlement.

(3) If any intellectual property proprietary to BSTP is necessary to develop, build, and operate links or interfaces to BSTP's matching service, as described in these conditions, BSTP shall license such intellectual property to other matching services seeking linkage to BSTP on fair and reasonable terms for use in such links or interfaces.

(4) BSTP shall not engage in any activity inconsistent with the purposes of Section 17A(a)(2) of the Exchange Act,<sup>258</sup> which section seeks the establishment of linked or coordinated facilities for clearance and settlement of transactions. In particular, BSTP will not engage in

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<sup>258</sup> 15 U.S.C. 78q-1(a)(2)(A)(ii).

activities that would prevent any other matching service from operating a matching service that it has developed independently from BSTP's matching service.

(5) BSTP shall support industry standards in each of the following categories: communication protocols (e.g., TCP/IP, SNA); message and file transfer protocols and software (e.g., FIX, WebSphere MQ, SWIFT); message format standards (e.g., FIX); and message languages and metadata (e.g., XML). However, BSTP need not support all existing industry standards or those listed above by means of example. Within three months of regulatory approval, BSTP shall make publicly known those standards supported by BSTP's matching service. To the extent that BSTP decides to support other industry standards, including new and modified standards, BSTP shall make these standards publicly known upon making such decision or within three months of updating its system to support such new standards, whichever is sooner. Any translation to/from these published standards necessary to communicate with BSTP's system shall be performed by BSTP without any significant delay or service degradation of the linked parties' services.

(6) BSTP shall make all reasonable efforts to link with each other matching service in a timely and efficient manner, as specified below. Upon written request, BSTP shall negotiate with each other matching service to develop and build an interface that allows the two to link matching services ("interface"). BSTP shall involve neutral industry participants in all negotiations to build or develop interfaces and, to the extent feasible, incorporate input from such participants in determining the specifications and architecture of such interfaces. Absent adequate business or technological justification,<sup>259</sup> BSTP and the requesting other matching

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<sup>259</sup> The failure of neutral industry participants to be available or to submit their input within the 120 day or 90 day time periods set forth in this paragraph shall not constitute an adequate

service shall conclude negotiations and reach a binding agreement to develop and build an interface within 120 calendar days of BSTP's receipt of the written request. This 120-day period may be extended upon the written agreement of both BSTP and the other matching service engaged in negotiations. For each other matching service with whom BSTP reaches a binding agreement to develop and build an interface, BSTP shall begin operating such interface within 90 days of reaching a binding agreement and receiving all the information necessary to develop and operate it. This 90-day period may be extended upon the written agreement of both BSTP and the other matching service. For each interface and within the same time BSTP must negotiate and begin operating each interface, BSTP and the other matching service shall agree to "commercial rules" for coordinating the provision of matching services through their respective interfaces, including commercial rules: (A) allocating responsibility for performing matching services; and (B) allocating liability for service failures. BSTP shall also involve neutral industry participants in negotiating applicable commercial rules and, to the extent feasible, take input from such participants into account in agreeing to commercial rules. At a minimum, each interface shall enable BSTP and the other matching service to transfer between them all trade and account information necessary to fulfill their respective matching responsibilities as set forth in their commercial rules ("trade and account information"). Absent an adequate business or technological justification, BSTP shall develop and operate each interface without imposing conditions that negatively impact the other matching service's ability to innovate its matching service or develop and offer other value-added services relating to its matching service or that negatively impact the other matching service's ability to compete effectively against BSTP.

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business or technological justification for failing to adhere to the requirements set forth in this paragraph.

(7) In order to facilitate fair and reasonable linkages between BSTP and other matching services, BSTP shall publish or make available to any other matching service the specifications for any interface and its corresponding commercial rules that are in operation within 20 days of receiving a request for such specifications and commercial rules. Such specifications shall contain all the information necessary to enable any other matching services not already linked to BSTP through an interface to establish a linkage with BSTP through an interface or a substantially similar interface. BSTP shall link to any other matching service, if the other matching service so opts, through an interface substantially similar to any interface and its corresponding commercial rules that BSTP is currently operating. BSTP shall begin operating such substantially similar interface and commercial rules with the other matching service within 90 days of receiving all the information necessary to operate that link. This 90-day period may be extended upon the written agreement of both BSTP and the other matching service that plans to use that link.

(8) BSTP and respective other matching services shall bear their own costs of building and maintaining an interface, unless otherwise negotiated by the parties.

(9) BSTP shall provide to all other matching services and end-user representatives that maintain linkages with BSTP sufficient advance notice of any material changes, updates, or revisions to its interfaces to allow all parties who link to BSTP through affected interfaces to modify their systems as necessary and avoid system downtime, interruption, or system degradation.

(10) BSTP and each other matching service shall negotiate fair and reasonable charges and terms of payment for the use of their interface with respect to the sharing of trade and account information ("interface charges"). In any fee schedule adopted under conditions

A.2.ii(10), A.2.ii(11), or A.2.ii(12) herein, BSTP's interface charges shall be equal to the interface charges of the respective other matching service.

(11) If BSTP and the other matching service cannot reach agreement on fair and reasonable interface charges within 60 days of receipt of the written request, BSTP and the other matching service shall submit to binding arbitration under the rules promulgated by the American Arbitration Association. The arbitration panel shall have 60 days to establish a fee schedule. The arbitration panel's establishment of a fee schedule shall be binding on BSTP and the other matching service unless and until the fee schedule is subsequently modified or abrogated by the Commission or BSTP and the other matching service mutually agree to renegotiate.

(12) (A) The following parameters shall be considered in determining fair and reasonable interface charges: (i) the variable cost incurred for forwarding trade and account information to other matching services; (ii) the average cost associated with the development of links to end-users and end-user representatives; and (iii) BSTP's interface charges to other matching services.

(B) The following factors shall not be considered in determining fair and reasonable interface charges: (i) the respective cost incurred by BSTP or the other matching service in creating and maintaining interfaces; (ii) the value that BSTP or the other matching service contributes to the relationship; (iii) the opportunity cost associated with the loss of profits to BSTP that may result from competition from other matching services; (iv) the cost of building, maintaining, or upgrading BSTP's matching service; or (v) the cost of building, maintaining, or upgrading value added services to BSTP's matching service. (C) In any event, the interface charges shall not be set at a level that unreasonably deters entry or otherwise diminishes price or non-price competition with BSTP by other matching services.

(13) BSTP shall not charge its customers more for use of its matching service when one or more counterparties are customers of other matching services than BSTP charges its customers for use of its matching service when all counterparties are customers of BSTP. BSTP shall not charge customers any additional amount for forwarding to or receiving trade and account information from other matching services called for under applicable commercial rules.

(14) BSTP shall maintain its quality, capacity, and service levels in the interfaces with other matching services (“matching services linkages”) without bias in performance relative to similar transactions processed completely within BSTP’s service. BSTP shall preserve and maintain all raw data and records necessary to prepare reports tabulating separately the processing and response times on a trade-by-trade basis for (A) completing its matching service when all counterparties are customers of BSTP; (B) completing its matching service when one or more counterparties are customers of other matching services; or (C) forwarding trade information to other matching services called for under applicable commercial rules. BSTP shall retain the data and records for a period not less than six years. Sufficient information shall be maintained to demonstrate that the requirements of condition A.2.ii(15) below are being met. BSTP and its service providers shall provide the Commission with reports regarding the time it takes BSTP to process trades and forward information under various circumstances within thirty days of the Commission’s request for such reports. However, BSTP shall not be responsible for identifying the specific cause of any delay in performing its matching service where the fault for such delay is not attributable to BSTP.

(15) BSTP shall process trades or facilitate the processing of trades by other matching services on a first-in-time priority basis. For example, if BSTP receives trade and account information that BSTP is required to forward to other matching services under applicable

commercial rules (“pass-through information”) prior to receiving trade and account information from BSTP’s customers necessary to provide matching services for a trade in which all parties are customers of BSTP (“intra-hub information”), BSTP shall forward the pass-through information to the designated other matching service prior to processing the intra-hub information. If, on the other hand, the information were to come in the reverse order, BSTP shall process the intra-hub information before forwarding the pass-through information.

(16) BSTP shall sell access to its databases, systems or methodologies for transmitting settlement instructions (including settlement instructions from investment managers, broker-dealers, and custodian banks) and/or transmitting trade and account information to and receiving authorization responses from settlement agents on fair and reasonable terms to other matching services and end-user representatives. Such access shall permit other matching services and end-user representatives to draw information from those databases, systems, and methodologies for transmitting settlement instructions and/or transmitting trade and account information to and receiving authorization responses from settlement agents for use in their own matching services or end-user representatives’ services. The links necessary for other matching services and end-user representatives to access BSTP’s databases, systems or methodologies for transmitting settlement instructions and/or transmitting trade and account information to and receiving authorization responses from settlement agents will comply with conditions A.2.ii(3), A.2.ii(5), A.2.ii(9), A.2.ii(14) and A.2.ii(15) above.

(17) For the first five years from the date of an exemptive order issued by the Commission with respect to BSTP’s matching service, BSTP shall provide the Commission with reports every six months sufficient to document BSTP’s adherence to the obligations relating to interfaces set forth in conditions A.2.ii(6) through A.2.ii(13) and A.2.ii(16) above. BSTP shall

incorporate into such reports information including but not limited to: (A) all other matching services linked to BSTP; (B) the time, effort, and cost required to establish each link between BSTP and other matching services; (C) any proposed links between BSTP and other matching services as well as the status of such proposed links; (D) any failure or inability to establish such proposed links or fee schedules for interface charges; (E) any written complaint received from other matching services relating to its established or proposed links with BSTP; and (F) if BSTP failed to adhere to any of the obligations relating to interfaces set forth in conditions A.2.ii(6) through A.2.ii(13) and A.2.ii(16) above, its explanation for such failure. The Commission shall treat information submitted in accordance with this condition as confidential, non-public information, subject to the provisions of applicable law. If any other matching service seeks to link with BSTP more than five years after issuance of an exemptive order issued by the Commission with respect to BSTP's matching service, BSTP shall notify the Commission of the other matching service's request to link with BSTP within ten days of receiving such request. In addition, BSTP shall provide reports to the Commission in accordance with this paragraph commencing six months after the initial request for linkage is made until one year after BSTP and the other matching service begin operating their interface. The Commission reserves the right to request reports from BSTP at any time. BSTP shall provide the Commission with such updated reports within thirty days of the Commission's request.

(18) BSTP shall also publish or make available upon request to any end-user representative the necessary specifications, protocols, and architecture of any interface created by BSTP for any end-user representative.

### 3. Modifications to Exemption

BSTP is required to file with the Commission amendments to its application for exemption on Form CA-1 if it makes any material change affecting its ETC or matching service—as summarized in this order, in its Form CA-1 dated March 15, 2013, or in any subsequently filed amendments to its Form CA-1—that would make such previously provided information incomplete or inaccurate.

In addition, the Commission may modify by order the terms, scope, or conditions of BSTP's exemption from registration as a clearing agency if it determines that such modification is necessary or appropriate in the public interest, the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. Furthermore, the Commission may limit, suspend, or revoke this exemption if it finds that BSTP has violated or is unable to comply with any of the provisions set forth in this order if such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.

#### B. SS&C

In evaluating the SS&C application, the Commission has been guided by the requirements of Section 17A of the Exchange Act. Among other factors, the Commission has considered SS&C's risk management procedures, operational capacity and safeguards, organizational structure, and ability to operate in a manner that will satisfy the fundamental goals of Section 17A. The Commission has also carefully considered the comments received in response to the SS&C application, as discussed above. The Commission believes that the SS&C application supports the establishment of linked and coordinated facilities for the clearance and settlement of securities transactions.

Accordingly, for the reasons discussed throughout this order, the Commission finds that the SS&C application, including the terms and conditions set forth in the application and reproduced below, is consistent with the public interest, the protection of investors, and the purposes of Section 17A of the Exchange Act, and that SS&C is so organized and has the capacity to be able to facilitate prompt and accurate matching services.

Below are the terms and conditions of SS&C's exemption.

1. Scope of Exemption

This order grants SS&C an exemption from registration as a clearing agency under Section 17A of the Exchange Act to provide an ETC and matching service. The exemption is granted subject to conditions that the Commission believes are necessary and appropriate in light of the statutory requirements of Section 17A.<sup>260</sup> This order and the conditions and limitations contained in it are consistent with the Commission's statement in the Matching Release that an entity that limits its clearing agency functions to providing matching services does not have to be subject to the full range of clearing agency regulation.

2. Conditions of Exemption

The Commission is including specific conditions to this exemption designed to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions and the establishment of linked and coordinated facilities for the clearance

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<sup>260</sup> The Commission is granting SS&C an exemption from clearing agency registration, so it will not be considered a self-regulatory organization under Section 3(a)(26) and therefore will not be required to file rule changes in accordance with Section 19(b) of the Exchange Act. The Commission is also not imposing a rule change filing requirement as a condition of the exemption.

and settlement of securities transactions. The conditions are designed to promote competition, transparency, consistency, and interoperability in the market for matching services.

i. Operational Conditions

(1) Before beginning the commercial operation of its matching service, SS&C shall provide the Commission with an audit report that addresses all the areas discussed in the Commission's Automation Review Policies ("ARP").<sup>261</sup>

(2) SS&C shall provide the Commission with annual reports and any associated field work prepared by competent, independent audit personnel that are generated in accordance with the annual risk assessment of the areas set forth in the ARP. SS&C shall provide the Commission (beginning in its first year of operation) with annual audited financial statements prepared by competent independent audit personnel.

(3) SS&C shall report all significant systems outages to the Commission. If it appears that the outage may extend for thirty minutes or longer, SS&C shall report the systems outage immediately. If it appears that the outage will be resolved in less than thirty minutes, SS&C shall report the systems outage within a reasonable time after the outage has been resolved.

(4) SS&C shall provide the Commission with 20 business days advance notice of any material changes that SS&C makes to the matching service or ETC service. These changes will not require the Commission's approval before they are implemented.

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<sup>261</sup> See Exchange Act Release Nos. 27445 (Nov. 16, 1989), 54 FR 48703 (Nov. 24, 1989) ("ARP I"), and 29185 (May 9, 1991), 56 FR 22490 (May 15, 1991) ("ARP II"); see also Memorandum from the Securities and Exchange Commission Division of Market Regulation to SROs and NASDAQ (June 1, 2001) ("Guidance for Systems Outages and System Change Notifications"), available at <http://www.sec.gov/divisions/marketreg/sro-guidance-for-systems-outage-06-01-2001.pdf>.

(5) SS&C shall respond and require its service providers to respond to requests from the Commission for additional information relating to the matching service and ETC service, and provide access to the Commission to conduct on-site inspections of all facilities (including automated systems and systems environment), records, and personnel related to the matching service and the ETC service. The requests for information shall be made and the inspections shall be conducted solely for the purpose of reviewing the matching service's and the ETC service's operations and compliance with the federal securities laws and the terms and conditions in any exemptive order issued by the Commission with respect to SS&C's matching service and the ETC service.

(6) SS&C shall supply the Commission or its designee with periodic reports regarding the affirmation rates for institutional transactions effected by institutional investors that utilize its matching service and ETC service.

(7) SS&C shall preserve a copy or record of all trade details, allocation instructions, central trade matching results, reports and notices sent to customers, service agreements, reports regarding affirmation rates that are sent to the Commission or its designee, and any complaint received from a customer, all of which pertain to the operation of its matching service and ETC service. SS&C shall retain these records for a period of not less than five years, the first two years in an easily accessible place.

(8) SS&C shall not perform any clearing agency function (such as net settlement, maintaining a balance of open positions between buyers and sellers, or marking securities to the market) other than as permitted in an exemption issued by the Commission.

(9) Before beginning the commercial operation of its matching service, SS&C shall provide the Commission with copies of the intercompany agreement between SS&C and SS&C Canada and shall notify the Commission of any material changes to the service agreement.

ii. Interoperability Conditions

(1) SS&C shall develop, in a timely and efficient manner, fair and reasonable linkages between SS&C's matching service and other matching services that are registered with the Commission or that receive or have received from the Commission an exemption from clearing agency registration that, at a minimum, allow parties to trades that are processed through one or more matching services to communicate through one or more appropriate effective interfaces with other matching services.

(2) SS&C shall devise and develop interfaces with other matching services that enable end-user clients or any service that represents end-user clients to SS&C ("end-user representative") to gain a single point of access to SS&C and other matching services. Such interfaces must link with each other matching service so that an end-user client of one matching service can communicate with all end-user clients of all matching services, regardless of which matching service completes trade matching prior to settlement.

(3) If any intellectual property proprietary to SS&C is necessary to develop, build, and operate links or interfaces to SS&C's matching service, as described in these conditions, SS&C shall license such intellectual property to other matching services seeking linkage to SS&C on fair and reasonable terms for use in such links or interfaces.

(4) SS&C shall not engage in any activity inconsistent with the purposes of Section 17A(a)(2) of the Exchange Act,<sup>262</sup> which section seeks the establishment of linked or coordinated facilities for clearance and settlement of transactions. In particular, SS&C will not engage in activities that would prevent any other matching service from operating a matching service that it has developed independently from SS&C's matching service.

(5) SS&C shall support industry standards in each of the following categories: communication protocols (e.g., TCP/IP, SNA); message and file transfer protocols and software (e.g., FIX, WebSphere MQ, SWIFT); message format standards (e.g., FIX); and message languages and metadata (e.g., XML). However, SS&C need not support all existing industry standards or those listed above by means of example. Within three months of regulatory approval, SS&C shall make publicly known those standards supported by SS&C's matching service. To the extent that SS&C decides to support other industry standards, including new and modified standards, SS&C shall make these standards publicly known upon making such decision or within three months of updating its system to support such new standards, whichever is sooner. Any translation to/from these published standards necessary to communicate with SS&C's system shall be performed by SS&C without any significant delay or service degradation of the linked parties' services.

(6) SS&C shall make all reasonable efforts to link with each other matching service in a timely and efficient manner, as specified below. Upon written request, SS&C shall negotiate with each other matching service to develop and build an interface that allows the two to link matching services ("interface"). SS&C shall involve neutral industry participants in all

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<sup>262</sup> 15 U.S.C. 78q-1(a)(2)(A)(ii).

negotiations to build or develop interfaces and, to the extent feasible, incorporate input from such participants in determining the specifications and architecture of such interfaces. Absent adequate business or technological justification,<sup>263</sup> SS&C and the requesting other matching service shall conclude negotiations and reach a binding agreement to develop and build an interface within 120 calendar days of SS&C's receipt of the written request. This 120-day period may be extended upon the written agreement of both SS&C and the other matching service engaged in negotiations. For each other matching service with whom SS&C reaches a binding agreement to develop and build an interface, SS&C shall begin operating such interface within 90 days of reaching a binding agreement and receiving all the information necessary to develop and operate it. This 90-day period may be extended upon the written agreement of both SS&C and the other matching service. For each interface and within the same time SS&C must negotiate and begin operating each interface, SS&C and the other matching service shall agree to "commercial rules" for coordinating the provision of matching services through their respective interfaces, including commercial rules: (A) allocating responsibility for performing matching services; and (B) allocating liability for service failures. SS&C shall also involve neutral industry participants in negotiating applicable commercial rules and, to the extent feasible, take input from such participants into account in agreeing to commercial rules. At a minimum, each interface shall enable SS&C and the other matching service to transfer between them all trade and account information necessary to fulfill their respective matching responsibilities as set forth in their commercial rules ("trade and account information"). Absent an adequate business or

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<sup>263</sup> The failure of neutral industry participants to be available or to submit their input within the 120 day or 90 day time periods set forth in this paragraph shall not constitute an adequate business or technological justification for failing to adhere to the requirements set forth in this paragraph.

technological justification, SS&C shall develop and operate each interface without imposing conditions that negatively impact the other matching service's ability to innovate its matching service or develop and offer other value-added services relating to its matching service or that negatively impact the other matching service's ability to compete effectively against SS&C.

(7) In order to facilitate fair and reasonable linkages between SS&C and other matching services, SS&C shall publish or make available to any other matching service the specifications for any interface and its corresponding commercial rules that are in operation within 20 days of receiving a request for such specifications and commercial rules. Such specifications shall contain all the information necessary to enable any other matching services not already linked to SS&C through an interface to establish a linkage with SS&C through an interface or a substantially similar interface. SS&C shall link to any other matching service, if the other matching service so opts, through an interface substantially similar to any interface and its corresponding commercial rules that SS&C is currently operating. SS&C shall begin operating such substantially similar interface and commercial rules with the other matching service within 90 days of receiving all the information necessary to operate that link. This 90-day period may be extended upon the written agreement of both SS&C and the other matching service that plans to use that link.

(8) SS&C and respective other matching services shall bear their own costs of building and maintaining an interface, unless otherwise negotiated by the parties.

(9) SS&C shall provide to all other matching services and end-user representatives that maintain linkages with SS&C sufficient advance notice of any material changes, updates, or revisions to its interfaces to allow all parties who link to SS&C through affected interfaces to

modify their systems as necessary and avoid system downtime, interruption, or system degradation.

(10) SS&C and each other matching service shall negotiate fair and reasonable charges and terms of payment for the use of their interface with respect to the sharing of trade and account information (“interface charges”). In any fee schedule adopted under conditions B.2.ii(10), B.2.ii(11), or B.2.ii(12) herein, SS&C’s interface charges shall be equal to the interface charges of the respective other matching service.

(11) If SS&C and the other matching service cannot reach agreement on fair and reasonable interface charges within 60 days of receipt of the written request, SS&C and the other matching service shall submit to binding arbitration under the rules promulgated by the American Arbitration Association. The arbitration panel shall have 60 days to establish a fee schedule. The arbitration panel’s establishment of a fee schedule shall be binding on SS&C and the other matching service unless and until the fee schedule is subsequently modified or abrogated by the Commission or SS&C and the other matching service mutually agree to renegotiate.

(12) (A) The following parameters shall be considered in determining fair and reasonable interface charges: (i) the variable cost incurred for forwarding trade and account information to other matching services; (ii) the average cost associated with the development of links to end-users and end-user representatives; and (iii) SS&C’s interface charges to other matching services. (B) The following factors shall not be considered in determining fair and reasonable interface charges: (i) the respective cost incurred by SS&C or the other matching service in creating and maintaining interfaces; (ii) the value that SS&C or the other matching service contributes to the relationship; (iii) the opportunity cost associated with the loss of profits to

SS&C that may result from competition from other matching services; (iv) the cost of building, maintaining, or upgrading SS&C's matching service; or (v) the cost of building, maintaining, or upgrading value added services to SS&C's matching service. (C) In any event, the interface charges shall not be set at a level that unreasonably deters entry or otherwise diminishes price or non-price competition with SS&C by other matching services.

(13) SS&C shall not charge its customers more for use of its matching service when one or more counterparties are customers of other matching services than SS&C charges its customers for use of its matching service when all counterparties are customers of SS&C. SS&C shall not charge customers any additional amount for forwarding to or receiving trade and account information from other matching services called for under applicable commercial rules.

(14) SS&C shall maintain its quality, capacity, and service levels in the interfaces with other matching services ("matching services linkages") without bias in performance relative to similar transactions processed completely within SS&C's service. SS&C shall preserve and maintain all raw data and records necessary to prepare reports tabulating separately the processing and response times on a trade-by-trade basis for (A) completing its matching service when all counterparties are customers of SS&C; (B) completing its matching service when one or more counterparties are customers of other matching services; or (C) forwarding trade information to other matching services called for under applicable commercial rules. SS&C shall retain the data and records for a period not less than six years. Sufficient information shall be maintained to demonstrate that the requirements of condition B.2.ii(15) below are being met. SS&C and its service providers shall provide the Commission with reports regarding the time it takes SS&C to process trades and forward information under various circumstances within 30 days of the Commission's request for such reports. However, SS&C shall not be responsible for

identifying the specific cause of any delay in performing its matching service where the fault for such delay is not attributable to SS&C.

(15) SS&C shall process trades or facilitate the processing of trades by other matching services on a first-in-time priority basis. For example, if SS&C receives trade and account information that SS&C is required to forward to other matching services under applicable commercial rules ("pass-through information") prior to receiving trade and account information from SS&C's customers necessary to provide matching services for a trade in which all parties are customers of SS&C ("intra-hub information"), SS&C shall forward the pass-through information to the designated other matching service prior to processing the intra-hub information. If, on the other hand, the information were to come in the reverse order, SS&C shall process the intra-hub information before forwarding the pass-through information.

(16) SS&C shall sell access to its databases, systems or methodologies for transmitting settlement instructions (including settlement instructions from investment managers, broker-dealers, and custodian banks) and/or transmitting trade and account information to and receiving authorization responses from settlement agents on fair and reasonable terms to other matching services and end-user representatives. Such access shall permit other matching services and end-user representatives to draw information from those databases, systems, and methodologies for transmitting settlement instructions and/or transmitting trade and account information to and receiving authorization responses from settlement agents for use in their own matching services or end-user representatives' services. The links necessary for other matching services and end-user representatives to access SS&C's databases, systems or methodologies for transmitting settlement instructions and/or transmitting trade and account information to and receiving

authorization responses from settlement agents will comply with conditions B.2.ii(3), B.2.ii(5), B.2.ii(9), B.2.ii(14) and B.2.ii(15) above.

(17) For the first five years from the date of an exemptive order issued by the Commission with respect to SS&C's matching service, SS&C shall provide the Commission with reports every six months sufficient to document SS&C's adherence to the obligations relating to interfaces set forth in conditions B.2.ii(6) through B.2.ii(13) and B.2.ii(16) above. SS&C shall incorporate into such reports information including but not limited to (A) all other matching services linked to SS&C; (B) the time, effort, and cost required to establish each link between SS&C and other matching services; (C) any proposed links between SS&C and other matching services as well as the status of such proposed links; (D) any failure or inability to establish such proposed links or fee schedules for interface charges; (E) any written complaint received from other matching services relating to its established or proposed links with SS&C; and (F) if SS&C failed to adhere to any of the obligations relating to interfaces set forth in conditions B.2.ii(6) through B.2.ii(13) and B.2.ii(16) above, its explanation for such failure. The Commission shall treat information submitted in accordance with this condition as confidential, non-public information, subject to the provisions of applicable law. If any other matching service seeks to link with SS&C more than five years after issuance of an exemptive order issued by the Commission with respect to SS&C's matching service, SS&C shall notify the Commission of the other matching service's request to link with SS&C within ten days of receiving such request. In addition, SS&C shall provide reports to the Commission in accordance with this paragraph commencing six months after the initial request for linkage is made until one year after SS&C and the other matching service begin operating their interface. The Commission reserves the right to request reports from SS&C at any time. SS&C shall

provide the Commission with such updated reports within thirty days of the Commission's request.

(18) SS&C shall also publish or make available upon request to any end-user representative the necessary specifications, protocols, and architecture of any interface created by SS&C for any end-user representative.

### 3. Modifications to Exemption

SS&C is required to file with the Commission amendments to its application for exemption on Form CA-1 if it makes any material change affecting its ETC or matching service—as summarized in this order, in its Form CA-1 dated April 15, 2013, or in any subsequently filed amendments to its Form CA-1—that would make such previously provided information incomplete or inaccurate.

In addition, the Commission may modify by order the terms, scope, or conditions of SS&C's exemption from registration as a clearing agency if it determines that such modification is necessary or appropriate in the public interest, the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. Furthermore, the Commission may limit, suspend, or revoke this exemption if it finds that SS&C has violated or is unable to comply with any of the provisions set forth in this order if such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.

### V. Conclusion

The Commission believes that the BSTP and SS&C applications demonstrate that BSTP and SS&C will have sufficient operational and processing capabilities to facilitate prompt and accurate matching services and to support the establishment of linked and coordinated facilities

for the clearance and settlement of securities transactions. The Commission also notes that BSTP and SS&C's exemptions will be subject to conditions that are designed to enable the Commission to monitor BSTP and SS&C's risk management procedures, operational capacity and safeguards, corporate structure, and ability to operate in a manner to further the fundamental goals of Section 17A of the Exchange Act. Therefore, for the reasons discussed throughout this order, the Commission finds that the BSTP and SS&C applications are consistent with the public interest, the protection of investors, and the purposes of Section 17A of the Exchange Act.

IT IS HEREBY ORDERED, pursuant to Section 17A(b)(1) of the Exchange Act, that the applications for exemption from registration as a clearing agency under Section 17A(b)(1) filed by Bloomberg STP LLC (File No. 600-33) and SS&C Technologies, Inc. (File No. 600-34) be, and hereby are, approved within the scope described in this order and subject to the terms and conditions contained in this order.

By the Commission.



Robert W. Errett  
Deputy Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 76523 / November 25, 2015**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4282 / November 25, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16971**

**In the Matter of**

**MICHAEL SZAFRANSKI,**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
PROCEEDINGS PURSUANT TO SECTION  
15(b) OF THE SECURITIES EXCHANGE  
ACT OF 1934 AND SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act ("Advisers Act") against Michael Szafranski ("Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2. below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below:

### III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

#### RESPONDENT

1. Respondent, age 37, is a resident of Surfside, Florida. Respondent was associated with Onyx Options Consultants Corp ("Onyx"), an investment adviser registered with the State of Florida. Onyx's registration was terminated in December 2010 for failure to renew its registration. From 2000 to 2001, Respondent was a registered representative with Bear, Stearns & Co., Inc., a formerly registered broker-dealer then registered with the Commission since 1985. From 2002 to 2007, Respondent was a registered representative with Sochet & Company, Inc., a formerly registered broker-dealer then registered with the Commission since 1986. Respondent previously held Series 7, 63, and 65 licenses.

#### ENTRY OF THE RESPONDENT'S CRIMINAL CONVICTION

2. On July 29, 2015, pursuant to a plea agreement, Respondent pled guilty in the United States District Court for the Southern District of Florida to the sole count of a superseding information charging him with conspiracy to commit wire fraud, in violation of 18 U.S.C. § 371, based on his conduct described herein. *United States v. Szafranski*, No. 15-cr-60010-WPD (S. D. Fla. Jan. 22, 2015). On October 26, 2015, Respondent was sentenced to 30 months imprisonment, followed by three years of supervised release, and the judgment of conviction was entered that same day.

3. The single count charged against Respondent was that he, along with Scott Rothstein ("Rothstein"), knowingly and willfully conspired to devise a scheme and artifice to defraud others to obtain money and property by means of false and fraudulent pretenses, representations, and promises, and that he knowingly transmitted and caused to be transmitted wire transfers of funds in furtherance of the scheme.

4. At the time of the conduct, Respondent acted as and was associated with an unregistered broker and was associated with an investment adviser registered with the State of Florida. The object of the conspiracy to which Respondent pled guilty was to enrich members of the conspiracy by convincing investors, through material misrepresentations and omissions, to purchase certain settlement agreements, offered by Rothstein, that turned out to be fictional. In or about January 2009, Respondent began soliciting investors to purchase these structured settlements. Pursuant to a written agreement with at least one such investor, Respondent had agreed to provide independent verification of these settlement agreements. Respondent received a sales commission from Rothstein for each such solicited transaction.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: Jill M. Peterson  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
Release No. 76528 / November 30, 2015

**INVESTMENT ADVISERS ACT OF 1940**  
Release No. 4284 / November 30, 2015

**ADMINISTRATIVE PROCEEDING**  
File No. 3-16975

**In the Matter of**

**MICHAEL L. SHEA**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS  
PURSUANT TO SECTION 15(b)(6) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
AND SECTIONS 203(f) and 203(k) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Michael L. Shea ("Shea" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 and Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### Summary

1. From September 2009 until July 2013, Shea was a vice president and the business development director at Alpha Fiduciary, Inc. ("AFI"), a registered investment adviser based in Phoenix, Arizona. From at least August 2010 until March 2013, AFI, its principal, and Shea created and distributed to clients and prospective clients performance advertising that failed to disclose with sufficient prominence and detail that AFI's Global Tactical Multi Asset Class Strategies' ("GTMACS") advertised performance was hypothetical rather than actual. AFI's principal created the GTMACS' performance data by back-testing static models dating back to 1999 and consisting of indices that generated minimized volatility and maximized returns, before either AFI or the GTMACS existed. While AFI provided several pieces of performance advertising generally disclosing its use of "certain hypothetical performance and portfolio information," that disclosure was imprecise, often not on the same page as the hypothetical performance data, and contrary to other statements indicating that the GTMACS' performance data represented actual rather than hypothetical returns. Shea also generated some performance advertising e-mails without any disclosure language and distributed it to a limited number of prospective clients. In addition, AFI's advertising included examples of favorable investment decisions showing returns of up to 58.62% without providing or offering to provide all the firm's investment decisions, and select client portfolios showing over 28% in annualized gains without determining whether those gains represented all AFI clients.

#### Respondent

2. Michael L. Shea, age 44, is a resident of Pleasant Hill, California. Shea was AFI's vice president and business development director from September 2009 until his termination in July 2013. He is currently associated with both a registered investment adviser and a dually registered broker-dealer and investment adviser.

#### Other Relevant Entity

3. Alpha Fiduciary, Inc. (SEC File No. 801-68218) is an Arizona corporation based in Phoenix, Arizona. AFI has been registered with the Commission as an investment adviser since 2007. As of May 29, 2015, AFI had \$737 million in assets under management held in 731 accounts.

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

## Background

4. AFI was formed in November 2006 and registered as an investment adviser with the Commission in August 2007. In 2010, AFI began marketing its GTMACS as an investment strategy designed to reduce portfolio volatility and enhance returns by investing in seven to ten global, diversified asset classes.

5. Beginning in 2010, AFI's principal designed models for the Balanced, Conservative, Growth, and Income GTMACS consisting of seven to nine equity, bond, commodity, and hedge fund indices representing ten asset classes. AFI's principal created the GTMACS' hypothetical performance by selecting a static allocation of seven to nine indices to maximize returns and minimize volatility when back-tested to 1999. The static GTMACS' model portfolios never represented the holdings of any AFI account, nor could they. Many of the indices comprising the models had no corresponding tracking product like a mutual fund or exchange-traded fund, making replication of the back-tested holdings impossible.

6. AFI's principal or Shea included the hypothetical performance of the GTMACS in charts and tables in AFI's various advertising pieces, such as two-page executive summaries, 25-page firm profiles, 60-page presentations, and website. AFI's principal and/or Shea periodically updated the GTMACS' performance data to the then most recent quarter, with comparisons to the performance of the S&P 500 index. For example, AFI's advertising materials presented that the GTMACS' Balanced model returned 163.34% from January 1999 through September 2012, compared to a 17.20% return by the S&P 500 during that same period.

7. AFI's executive summaries, firm profiles, and presentations disclosed that they contained "certain hypothetical performance and portfolio information," but did not disclose that all of the GTMACS' performance data was completely hypothetical. In AFI's firm profiles and presentations, the disclosure language did not appear on the same page as the hypothetical performance data, but at or near the end of a 25 or 60 page document.

8. In fact, AFI's advertising materials contained statements suggesting that the GTMACS' hypothetical performance data represented actual returns. For example, AFI's firm profile stated "[s]ince January 1999 our Balanced GTMAC Strategy Index has produced a 6.98% annualized rate of return. Similarly, AFI's presentation invited prospective clients to "Try it on!" and indicated that "if you would have invested with Alpha Fiduciary over the last ten years," a one million dollar investment would have increased to almost \$2.4 million, representing a 119.61% rate of return.

9. Shea knew that the GTMACS' performance data was hypothetical and based on a static, back-tested allocation of seven to nine indices. Nevertheless, Shea emailed a handful of clients and prospective clients the GTMACS' hypothetical performance data without including the disclosure about "certain hypothetical performance and portfolio information." In several emails to prospective clients, Shea also made misleading statements suggesting the hypothetical GTMACS' model performance data represented actual past performance.

10. AFI's advertising materials also contained seven examples of investment decisions made using the GTMACS in 2009 and 2010 generating realized or unrealized gains of 5.51% to 58.62%. All of the advertised investment decisions were profitable, yet some of AFI's investment decisions during those two years were not profitable. AFI never provided, or offered to provide, a list of all its profitable and unprofitable investment decisions during that time period to prospective clients.

11. AFI, through Shea, also provided prospective clients with a report of an existing client's portfolio, selected by AFI's principal, one of which, for example, presented a 14.4% return net of fees over a six-month period, without taking any steps to determine whether it was representative of the performance of other AFI clients.

### Violations

12. As a result of the conduct described above, AFI willfully violated<sup>2</sup> Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act, but may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5, (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

13. As a result of the conduct described above, AFI willfully violated Section 206(4) of the Advisers Act and Rules 206(4)-1(a)(2) & (5) thereunder. Section 206(4) prohibits any investment adviser from engaging in "any act, practice, or course of business which is fraudulent, deceptive, or manipulative," and authorizes the Commission to prescribe rules designed to prevent such conduct. Rule 206(4)-1(a)(2) makes it a fraudulent, deceptive, or manipulative act, practice, or course of business for a registered investment adviser to publish, circulate, or distribute any advertisement which refers, directly or indirectly, to past specific recommendations of such investment adviser which were or would have been profitable to any person without offering to furnish a list of all recommendations made by such investment adviser within the immediately preceding period of not less than one year. Rule 206(4)-1(a)(5) makes it a fraudulent, deceptive, or manipulative act, practice, or course of business for a registered investment adviser to publish, circulate, or distribute any advertisement which contains any untrue statement of a material fact, or which is otherwise false or misleading.

14. As a result of the conduct described above, Shea willfully aided and abetted and caused AFI's violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1(a)(2) & (5) thereunder. Shea knew or was generally aware of the potential of the hypothetical GTMACS' model performance, tactical applications of the GTMACS, and sample client portfolios in AFI's

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<sup>2</sup> A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

marketing materials to mislead clients and prospective clients about AFI's actual performance. Shea also knowingly or recklessly provided substantial assistance to AFI's primary antifraud and advertising violations by co-authoring AFI's advertising materials and creating and distributing performance advertising without any disclosure that the GTMACS' model performance data was hypothetical.

#### Civil Penalties

15. Shea has submitted a sworn Statement of Financial Condition dated May 21, 2015 and other evidence and has asserted his inability to pay a civil penalty.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 15(b)(6) of the Exchange Act and Sections 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Shea cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-1 promulgated thereunder.

B. Respondent Shea is censured.

C. Respondent Shea shall pay a civil penalty of \$25,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). Payment shall be made in the following installments:

- (1) \$5,000 within ten (10) days of entry of this Order;
- (2) \$5,000 within 180 days of entry of this Order;
- (3) \$5,000 within 360 days of entry of this Order;
- (4) \$5,000 within 540 days of entry of this Order; and
- (5) \$5,000 within 720 days of entry of this Order.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent Shea may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Shea as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Lorraine B. Echavarría, Associate Regional Director, Los Angeles Regional Office, Securities and Exchange Commission, 444 S. Flower Street, Suite 900, Los Angeles, CA 90071.

D. Based upon Respondent Shea's sworn representations in his Statement of Financial Condition dated May 21, 2015 and other documents submitted to the Commission, the Commission is not imposing a penalty greater than \$25,000 against him.

E. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent Shea provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of the maximum civil penalty allowable under the law. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of a penalty should not be ordered; (3) contest the imposition of the maximum penalty allowable under the law; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: **Jill M. Peterson**  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4283 / November 30, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16974**

**In the Matter of**

**ALPHA FIDUCIARY, INC.,**  
**and ARTHUR T. DOGLIONE,**

**Respondents.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS  
PURSUANT TO SECTIONS 203(e), 203(f),  
AND 203(k) OF THE INVESTMENT  
ADVISERS ACT OF 1940, MAKING  
FINDINGS, AND IMPOSING REMEDIAL  
SANCTIONS AND A CEASE-AND-DESIST  
ORDER**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Alpha Fiduciary, Inc. ("AFI") and Arthur T. Doglione ("Doglione") (collectively, "the Respondents").

**II.**

In anticipation of the institution of these proceedings, Respondents have each submitted an Offer of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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### III.

On the basis of this Order and Respondents' Offers, the Commission finds<sup>1</sup> that:

#### Summary

1. From at least August 2010 until March 2013, Respondents and AFI's former vice president and business development director created and distributed to clients and prospective clients performance advertising that failed to disclose with sufficient prominence and detail that AFI's Global Tactical Multi Asset Class Strategies' ("GTMACS") advertised performance was hypothetical rather than actual. Doglione created the GTMACS' performance data by back-testing static models dating back to 1999 and consisting of indices that generated minimized volatility and maximized returns, before either AFI or the GTMACS existed. While AFI provided several pieces of performance advertising generally disclosing its use of "certain hypothetical performance and portfolio information," that disclosure was imprecise, often not on the same page as the hypothetical performance data, and contrary to other statements indicating that the GTMACS' performance data represented actual rather than hypothetical returns. AFI's former vice president and business development director also created performance advertising without any disclosure language and distributed it to a limited number of prospective clients. In addition, AFI's advertising included examples of favorable investment decisions showing returns of up to 58.62% without providing or offering to provide all the firm's investment decisions, and select client portfolios showing over 28% in annualized gains without determining whether those gains represented all AFI clients.

2. AFI also failed to implement written compliance policies and procedures reasonably designed to prevent its employees from presenting performance advertising to clients or prospective clients that violated the Advisers Act and its rules.

#### Respondents

3. Alpha Fiduciary, Inc. (SEC File No. 801-68218) is an Arizona corporation based in Phoenix, Arizona. AFI has been registered with the Commission as an investment adviser since 2007. As of May 29, 2015, AFI had \$737 million in assets under management held in 731 accounts.

4. Arthur T. Doglione, age 53, is a resident of Scottsdale, Arizona. Doglione is the majority owner, managing member, and president of AFI, and until April 2014, its chief compliance officer.

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<sup>1</sup> The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

## Background

5. Doglione formed AFI in November 2006 and registered it as an investment adviser with the Commission in August 2007. In 2010, AFI began marketing its GTMACS as an investment strategy designed to reduce portfolio volatility and enhance returns by investing in seven to ten global, diversified asset classes.

6. Beginning in 2010, Respondents designed models for the Balanced, Conservative, Growth, and Income GTMACS consisting of seven to nine equity, bond, commodity, and hedge fund indices representing ten asset classes. Respondents created the GTMACS' hypothetical performance by selecting a static allocation of seven to nine indices to maximize returns and minimize volatility when back-tested to 1999. The static GTMACS' model portfolios never represented the holdings of any AFI account, nor could they. Many of the indices comprising the models had no corresponding tracking product like a mutual fund or exchange-traded fund, making replication of the back-tested holdings impossible.

7. Respondents included the hypothetical performance of the GTMACS in charts and tables in AFI's various advertising pieces, such as two-page executive summaries, 25-page firm profiles, 60-page presentations, and website. Respondents and/or AFI's former vice president and business development director periodically updated the GTMACS' performance data to the then most recent quarter, with comparisons to the performance of the S&P 500 index. For example, AFI's advertising materials presented that the GTMACS' Balanced model returned 163.34% from January 1999 through September 2012, compared to a 17.20% return by the S&P 500 during that same period.

8. AFI's executive summaries, firm profiles, and presentations disclosed that they contained "certain hypothetical performance and portfolio information," but did not disclose that all of the GTMACS' performance data was completely hypothetical. In AFI's firm profiles and presentations, the disclosure language did not appear on the same page as the hypothetical performance data, but at or near the end of a 25 or 60 page document.

9. In fact, AFI's advertising materials contained statements suggesting that the GTMACS' hypothetical performance data represented actual returns. For example, AFI's firm profile stated "[s]ince January 1999 our Balanced GTMAC Strategy Index has produced a 6.98% annualized rate of return. Similarly, AFI's presentation invited prospective clients to "Try it on!" and indicated that "if you would have invested with Alpha Fiduciary over the last ten years," a one million dollar investment would have increased to almost \$2.4 million, representing a 119.61% rate of return.

10. AFI employees knew that the GTMACS' performance data was hypothetical and based on a static, back-tested allocation of seven to nine indices. Nevertheless, AFI's former vice president and business development director emailed a handful of clients and prospective clients the GTMACS' hypothetical performance data without including even the disclosure about "certain hypothetical performance and portfolio information." In several e-mails to prospective clients,

AFI's former vice president and business development director also made misleading statements suggesting the hypothetical GTMACS' model performance data represented actual past performance.

11. AFI's advertising materials also contained examples of investment decisions made using the GTMACS in 2009 and 2010 generating realized or unrealized gains of 5.51% to 58.62%. All of the advertised investment decisions were profitable, yet some of AFI's investment decisions during those two years were not profitable. AFI never provided, or offered to provide, a list of all its profitable and unprofitable investment decisions during that time period to prospective clients.

12. AFI, through its former vice president and business development director, also provided prospective clients with a redacted report of an existing client's portfolio, one of which, for example, presented a 14.4% return net of fees over a six-month period. Respondents selected the sample client portfolio without considering whether it was representative of the performance of other AFI clients.

13. AFI adopted its Compliance and Procedures Manual before the firm began using performance advertising in 2010, but the Manual was not updated until December 2013. Before December 2013, AFI's Manual contained a section entitled "Marketing Materials and Advertising" that described Rule 206(4)-1 of the Advisers Act and stated that "particular care must be taken to ensure that materials presenting the composite performance of [AFI's] accounts meet SEC rules and interpretations." AFI's Manual required the chief compliance officer's prior review and approval of any marketing materials or advertising published or circulated to clients or prospective clients. Doglione exercised sole authority over AFI's policies and procedures, and he was solely responsible for the review and approval of AFI's marketing materials prior to their distribution to clients or prospective clients.

#### Violations

14. As a result of the conduct described above, AFI willfully violated<sup>2</sup> Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act, but may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5, (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

15. As a result of the conduct described above, AFI willfully violated Section 206(4) of the Advisers Act and Rules 206(4)-1(a)(2) & (5) thereunder. Section 206(4) prohibits any investment adviser from engaging in "any act, practice, or course of business which is fraudulent, deceptive, or manipulative," and authorizes the Commission to prescribe rules designed to prevent

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<sup>2</sup> A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

such conduct. Rule 206(4)-1(a)(2) makes it a fraudulent, deceptive, or manipulative act, practice, or course of business for a registered investment adviser to publish, circulate, or distribute any advertisement which refers, directly or indirectly, to past specific recommendations of such investment adviser which were or would have been profitable to any person without offering to furnish a list of all recommendations made by such investment adviser within the immediately preceding period of not less than one year. Rule 206(4)-1(a)(5) makes it a fraudulent, deceptive, or manipulative act, practice, or course of business for a registered investment adviser to publish, circulate, or distribute any advertisement which contains any untrue statement of a material fact, or which is otherwise false or misleading.

16. As a result of the conduct described above, AFI also willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require that registered advisers adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules adopted by the Commission under the Act. A violation of Section 206(4) and the rules thereunder do not require scienter. *Steadman*, 967 F.2d at 647.

17. As a result of the conduct described above, Doglione willfully aided and abetted and caused AFI's violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1(a)(2) & (5) thereunder. Doglione knew or was generally aware of the potential of the hypothetical GTMACS' model performance, tactical applications of the GTMACS, and sample client portfolios in AFI's marketing materials to mislead clients and prospective clients about AFI's actual performance. He also knowingly or recklessly provided substantial assistance to AFI's primary violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1(a)(2) & (5) thereunder by creating the GTMACS' hypothetical performance data, co-authoring and/or approving the marketing materials that contained the misleading presentation of the GTMACS' model performance, and choosing the client portfolios used in advertising without determining whether those portfolios' returns were representative of AFI's performance.

18. As a result of the conduct described above, Doglione willfully aided and abetted and caused AFI's violation of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. Doglione knew or was generally aware that AFI failed to implement procedures reasonably designed to prevent violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1(a)(2) & (5) thereunder. By failing to consult the applicable sources of guidance as specified in AFI's compliance manual for the review and approval of advertising materials, Doglione knowingly or recklessly provided substantial assistance to AFI's primary violation of Rule 206(4)-7.

#### **AFI's Remedial Efforts**

19. In determining to accept Respondents' Offers, the Commission considered remedial acts undertaken by Respondents and cooperation afforded the Commission staff.

## Undertakings

20. Respondent AFI has undertaken to:
21. Order Notification
  - a. Within thirty (30) days of the issuance of this Order, AFI shall mail to each of its existing clients a copy of the Form ADV which incorporates the paragraphs contained in Section III of this Order, and which specifies that the Order will be posted on the homepage of AFI's website;
  - b. Provide a copy of the Form ADV which incorporates the paragraphs contained in Section III of Order to any prospective client for a period of one (1) year after entry of this Order; and
  - c. Within thirty (30) days of the issuance of this Order, AFI shall post a copy of this Order on the homepage of AFI's website and maintain it there for a period of six (6) months.
22. Independent Compliance Consultant
  - a. AFI shall retain, within thirty (30) days of the issuance of this Order, the services of an Independent Compliance Consultant not unacceptable to the staff of the Commission's Los Angeles Regional Office. The Independent Compliance Consultant's compensation and expenses shall be borne exclusively by AFI. AFI shall require the Independent Compliance Consultant to conduct a review of AFI's compliance program, including its policies and procedures relating to the publication, circulation, or distribution of advertisements under Section 206(4) of the Advisers Act and Rule 206(4)-1(a) thereunder. AFI shall cooperate fully with the Independent Compliance Consultant and shall provide the Independent Compliance Consultant with access to any of its files, books, records and personnel as reasonably requested for review; provided, however, that AFI need not provide access to materials as to which AFI may assert a valid claim of attorney-client privilege;
  - b. At the conclusion of the review, which in no event shall be more than four (4) months after the issuance of this Order, AFI shall require the Independent Compliance Consultant to submit an Initial Report to AFI and to the staff of the Commission's Los Angeles Regional Office. The Initial Report shall describe the review performed, the conclusions reached, and shall include any recommendations deemed necessary to make the policies and procedures adequate;

- c. Within fifteen (15) days after receipt of the Independent Compliance Consultant's Initial Report, AFI shall in writing advise the Independent Compliance Consultant and the staff of the Commission's Los Angeles Regional Office of any recommendations that it considers to be unnecessary or inappropriate. AFI may suggest an alternative procedure designed to achieve the same objective or purpose as that of the recommendation of the Independent Compliance Consultant. The Independent Compliance Consultant shall evaluate any alternative procedure proposed by AFI. However, AFI shall abide by the Independent Compliance Consultant's final recommendation;
- d. Within six (6) months after the issuance of this Order, AFI shall, in writing, advise the Independent Compliance Consultant and the staff of the Commission's Los Angeles Regional Office of the recommendations it is adopting;
- e. Within nine (9) months after the issuance of this Order, AFI shall require the Independent Compliance Consultant to complete its review and submit a written final report to the staff of the Commission's Los Angeles Regional Office. The Final Report shall describe the review made of AFI's compliance policies and procedures; set forth the conclusions reached and the recommendations made by the Independent Compliance Consultant, as well as any proposals made by AFI; and describe how AFI is implementing the Independent Compliance Consultant's final recommendations;
- f. AFI shall take all necessary and appropriate steps to adopt and implement all recommendations contained in the Independent Compliance Consultant's Final Report; and
- g. AFI shall require the Independent Compliance Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Compliance Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with AFI, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Compliance Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Compliance Consultant in performance of his/her duties under this Order shall not, without prior written consent of the staff of the Commission's Los Angeles Regional Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with AFI, or any of its present or former affiliates, directors,

officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

23. For good cause shown and upon timely application by the Independent Compliance Consultant or AFI, the staff of the Commission's Los Angeles Regional Office may extend any of the deadlines set forth in these undertakings.

24. AFI shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and AFI agrees to provide such evidence. The certification and supporting material shall be submitted to Spencer E. Bendell, Assistant Regional Director, Los Angeles Regional Office, Securities and Exchange Commission, 444 S. Flower Street, Suite 900, Los Angeles, CA 90071, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Sections 203(e), 203(f), and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent AFI cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1 and 206(4)-7 promulgated thereunder.

B. Respondent Doglione cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1 and 206(4)-7 promulgated thereunder.

C. Respondents AFI and Doglione are censured.

D. Respondents shall pay civil penalties of \$250,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Securities Exchange Act of 1934, Section 21F(g)(3). Payment shall be made in the following installments:

- (1) \$100,000 within ten (10) days of entry of this Order;
- (2) \$50,000 within 180 days of entry of this Order;
- (3) \$50,000 within 270 days of entry of this Order; and
- (4) \$50,000 within 360 days of entry of this Order.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application. Respondents AFI and Doglione are jointly and severally liable for all payments required to be made by this paragraph. Payment must be made in one of the following ways:

- (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying AFI and Doglione as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Lorraine B. Echavarria, Associate Regional Director, Los Angeles Regional Office, Securities and Exchange Commission, 444 S. Flower Street, Suite 900, Los Angeles, CA 90071.

E. Respondent AFI shall comply with the undertakings enumerated in Section III, paragraphs 21-24 above.

By the Commission.

Brent J. Fields  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 9981 / November 30, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16973**

**In the Matter of**

**STANDARD BANK PLC**

**Respondent.**

**ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS PURSUANT  
TO SECTION 8A OF THE SECURITIES  
ACT OF 1933, MAKING FINDINGS,  
AND IMPOSING REMEDIAL  
SANCTIONS AND A CEASE-AND-  
DESIST ORDER**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") against Standard Bank Plc ("Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, and except as to facts set forth in the Statement of Facts filed in a matter captioned *Serious Fraud Office v. Standard Bank Plc*, No. U20150854, Southwark Crown Court, United Kingdom, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### Summary

This case involves Standard Bank Plc's ("Standard") failure to disclose payments made by Standard's affiliate, Stanbic Bank Tanzania, Limited ("Stanbic"), in connection with \$600 million of sovereign debt securities issued by the Government of Tanzania ("GoT") in 2013. Standard (an international investment bank located in London) was aware that its affiliate, Stanbic, paid \$6 million of the proceeds of the offering to an entity called Enterprise Growth Markets Advisors Limited ("EGMA"). Standard failed to disclose the existence of EGMA and the fees it was to receive. At all relevant times, EGMA's chairman and one of its three shareholders and directors was a representative of the GoT. Several red flags indicated the risk that the portion of the offering proceeds paid to EGMA by Stanbic was intended to induce the GoT to grant the mandate for the transaction to Standard and Stanbic. Standard acted as joint Lead Manager in the offering of Tanzanian sovereign debt securities without disclosing that EGMA was involved in the transaction and would receive a substantial fee in connection with the transaction.

#### Respondent

**Standard Bank Plc (Standard)** at all relevant times was the London-based international investment bank subsidiary of the Standard Bank Group Limited of South Africa. Standard is regulated by the Financial Conduct Authority and the Prudential Regulatory Authority in the United Kingdom. In February 2015, the Industrial and Commercial Bank of China ("ICBC") acquired a 60% stake in Standard. In March 2015, Standard announced that it had changed its name to ICBC Standard Bank Plc. ICBC did not own shares in Standard at the time of the relevant events and ICBC had no involvement in the events.

#### Other Relevant Individuals and Entities

1. **Stanbic Bank Tanzania Limited (Stanbic)**, a member of the Standard Bank Group of South Africa, provides various banking products and services in Tanzania. It is headquartered in Dar es Salaam, Tanzania.
2. **Enterprise Growth Market Advisors Limited (EGMA)** is a private company incorporated in Tanzania in August 2011 to support "companies in raising capital through the capital markets." It entered into a collaboration agreement (the "Collaboration Agreement") with Stanbic in connection with this transaction pursuant to which it received a fee of 1 percent of the proceeds raised in the issue, which amounted to \$6 million.

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

3. **Standard's Global Head of Debt Capital Markets** was based in London, and led the Standard debt capital markets team for the Tanzanian sovereign debt transaction. He resigned from Standard in December 2014 after having worked there since 2005.

4. **Stanbic's Managing Director** was CEO and a member of Stanbic's Board. He was dismissed by Stanbic in August 2013 for failing to cooperate in Standard Bank Group's investigation of EGMA's role in the transaction.

5. **Stanbic's Acting Head of Corporate and Investment Banking** served as the main contact point for Stanbic and Standard with government officials in Tanzania. Stanbic's Acting Head of Corporate and Investment Banking reported directly to Stanbic's Managing Director. She resigned from Stanbic in June 2013.

6. **The Commissioner of the Tanzania Revenue Authority** was a founding member, director and shareholder of EGMA. At all relevant times he was also a member of a Government agency that was an advisor to the GoT concerning the sovereign's financing needs.

### **Background**

7. From 2011 into early 2013, in an effort to help the GoT raise funds needed for infrastructure projects through the international bond market, in circumstances where the GoT had been unsuccessful in obtaining a credit rating, making a EuroBond offering unfeasible, Standard and Stanbic attempted to obtain a mandate from the GoT through its Minister of Finance (MoF) to raise funds through a private placement of sovereign debt. The proposals that Standard and Stanbic originally presented to the MoF anticipated that Standard and Stanbic would receive a combined fee of 1.4% of the gross proceeds for arranging the transaction (which would be split evenly between them). Standard and Stanbic proposed a transaction that would be marketed as a private placement in the U.S. pursuant to Securities and Exchange Commission Regulation S.

8. In an e-mail dated February 25, 2012, Stanbic's Acting Head of Corporate and Investment Banking informed certain persons at Standard and Stanbic, including Standard's Global Head of Debt Capital Markets and Stanbic's Managing Director, that the proposal had been accepted by the MoF. In bold print, Stanbic's Acting Head of Corporate and Investment Banking informed that "we pocket 1.4% arrangement fees." However, in May 2012, before the mandate was signed, the MoF was replaced by a new MoF.

9. From May 2012 through the end of 2012, Standard and Stanbic attempted to ensure the GoT's continued interest in their proposal for funding, primarily through the efforts of Stanbic's Acting Head of Corporate and Investment Banking and Stanbic's Managing Director to meet with government officials in Tanzania. Standard's Global Head of Debt Capital Markets was kept apprised of the progress and Standard, together with external counsel, was to be responsible for drafting the transaction documentation. In June 2012, Stanbic's Acting Head of Corporate and Investment Banking forwarded to the office of the MoF a copy of the proposal for funding, continuing to show Standard and Stanbic as Joint Lead Managers, receiving a fee of 1.4% of the gross proceeds of the transaction. In July 2012, Stanbic hired the son of the new MoF.

10. On August 29, 2012, Stanbic's Acting Head of Corporate and Investment Banking e-mailed Standard's Global Head of Debt Capital Markets that she and Stanbic's Managing Director had just come from a "very good meeting with the Minister of Finance and his key technical team" and that they were now in agreement with the proposal and would look at the Mandate Letter. Stanbic's Acting Head of Corporate and Investment Banking also informed Standard's Global Head of Debt Capital Markets that Standard's Global Head of Debt Capital Markets' meeting with the MoF was confirmed for September 18. On September 4, Stanbic's Acting Head of Corporate and Investment Banking sent Stanbic's Managing Director and the MoF's son a Proposal Letter and draft of the Mandate Letter, and asked the MoF's son to dispatch the documents to the MoF's office, the Ministry of Finance, which he did the next day. This version of the Proposal Letter shows an "ALL in Fee of 2.4%" and the draft Mandate Letter, which was enclosed with the Proposal Letter, defines the "Lead Manager" as Stanbic and Standard, "in collaboration with its Local Partner."

11. Stanbic was to pay the local partner, who Standard later learned was EGMA, a fee of 1% of the offering, from the total offering fee which had increased from 1.4% to 2.4% of the offering. In an e-mail dated September 20, 2012, from Standard's Global Head of Debt Capital Markets to Stanbic's Managing Director and Stanbic's Acting Head of Corporate and Investment Banking, Standard's Global Head of Debt Capital Markets states that "we are working on the Side Letter between us and our Partners, pointing out the fee split and the respective duties under the mandate." Attached to the e-mail is a copy of the most recent Mandate Letter sent to the MoF, which is edited to define the "Lead Manager" as only Stanbic and Standard, without mention of any Local Partner. When a Standard deal team member responded to Stanbic's Acting Head of Corporate and Investment Banking that the local partner would still need to be a signatory to the Mandate Letter, Stanbic's Acting Head of Corporate and Investment Banking responded, also copying Stanbic's Managing Director and Standard's Global Head of Debt Capital Markets that, "No. Intention is to bring them in through a side agreement between us and the partner. In other transactions they have done, [another bank] etc this is how it was done. Government would like to deal with the one party who then brings in and manages/coordinates the other partners...."

#### **Standard's Failure to Disclose**

12. Standard was negligent in not taking any steps to understand what role EGMA would be playing in the transaction in return for its \$6 million fee and there are no records of contemporaneous communications among Standard and Stanbic personnel concerning the ownership of EGMA, its relationship to the GoT, or why it was being made part of the transaction. On September 20, 2012, Standard's Global Head of Debt Capital Markets, Stanbic's Managing Director and Stanbic's Head of Corporate and Investment Banking held a telephone conference to discuss the logistics of splitting the fee with EGMA. Standard could not pay EGMA without going through a "Know Your Customer" (KYC) process to verify customer identity, among other things. Accordingly, Standard's Global Head of Debt Capital Markets, Stanbic's Managing Director and Stanbic's Acting Head of Corporate and Investment Banking agreed that Stanbic alone would perform KYC procedures with respect to EGMA. In that call, Standard's Global Head of Debt Capital Markets stated that he assumed that "there would [be] no problem whatsoever in KYC-ing these guys" and "I suppose you have done business with them and know these guys." The participants on the call also agreed that the entire fee of 2.4%

would be paid to Stanbic, which would then pay EGMA its 1% and remit back to Standard its portion of the remaining 1.4% fee. As a result, Standard was not a signatory to the fee agreement with EGMA. In a conference call on September 26, 2012, the same participants agreed that since EGMA would not be performing any duties as Lead Manager, it need not be mentioned in the mandate letter with the GoT at all.

13. At Stanbic's request, Standard took an active role in drafting the Collaboration Agreement between Stanbic and EGMA. Between September 2012 and February 2013, Stanbic and Standard revised several versions of the Collaboration Agreement. The Collaboration Agreement stated EGMA's responsibilities in connection with the transaction. There is no evidence that EGMA performed those responsibilities.

14. The GoT, through the MoF executed a Mandate Letter with Standard and Stanbic dated November 15, 2012 appointing Standard and Stanbic jointly as Lead Manager in connection with the debt financing for the GoT. The Mandate Letter included a "total facilitation" fee of 2.4%, but did not mention any local partner or third party. The Lead Manager's fee letter attached to the Mandate Letter indicates that the 2.4% fee would be paid to Standard and Stanbic as lead manager "in collaboration with its partner." Although, the Fee Letter referred to a "local partner," EGMA was not identified as that local partner.

15. On February 25, 2013, Standard's Global Head of Debt Capital Markets participated in a call with potential investors in the Tanzanian Sovereign Bond. Representatives of the GoT who were on the call included the MoF, as well as the Commissioner of the Tanzania Revenue Authority, who was an EGMA shareholder. In the call, Standard's Global Head of Debt Capital Markets provided a brief summary of the terms of the notes, and told the audience that the transaction would not be listed nor rated and that to subscribe would require agreement to an investor representation letter which had been provided to the potential investors. The investor representation letter required the investors to acknowledge and agree that Standard made no representations or warranties about the private placement and that "neither Standard nor any of its Associates is responsible or liable for any misstatements in or omission from [information relating to the Issuer, the Loan Notes, and the Transaction, Transaction Documents and Public Domain Information as those terms are defined in the investor representation letter]." The investor representation letter failed to include material facts about the transactions namely any mention of EGMA, its shareholders' ties to the GoT, its lack of a substantive role in the transaction, and that it was to receive a \$6 million fee.

16. Standard did not disclose the involvement of EGMA and the fee EGMA was to receive. Standard assisted in drafting the Fee Letter whereby the GoT agreed to pay Standard, Stanbic and a "partner" a combined fee of 2.4%, with no specific mention of EGMA's name.

17. On February 27, 2013, the GoT issued its floating-rate amortizing, unrated, unlisted, sovereign bonds through a Regulation S private placement. As set forth in the transaction documents, the gross proceeds of \$600 million were transferred by the facility agent to the GoT's account in New York, on March 8, the GoT then transferred the total 2.4% fee of \$14.4 million to Stanbic in Tanzania. Stanbic deposited EGMA's 1% fee, or \$6 million, into an account EGMA had previously opened at Stanbic. After EGMA made payments of the legal

costs related to the transaction, approximately \$5.2 million of its \$6 million was withdrawn in cash between March 18 and 27, 2013. Standard did not become aware of those cash withdrawals until after they were made, and does not have knowledge as to the ultimate disposition of those withdrawn funds.

18. By offering the Tanzanian sovereign bonds, Standard had a duty to disclose to investors material facts that it knew or should have known concerning the transaction.

19. As a result of the conduct in failing to disclose the material facts described above, Respondent committed violations of Sections 17(a)(2) of the Securities Act.

#### **Standard's Cooperation**

20. In determining to accept the Offer, the Commission considered the cooperation afforded the Commission staff by Standard and its former corporate parent, Standard Bank Group. After receiving communications from employees concerned about the cash withdrawals from EGMA's account at Stanbic in Tanzania, Standard and Standard Bank Group promptly and voluntarily reported the matter to the U.K. Serious Fraud Office and undertook a comprehensive internal investigation. Standard and Standard Bank Group also provided significant cooperation with the Commission's investigation.

#### **IV.**

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 8A of the Securities Act it is hereby ORDERED that:

- A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) of the Securities Act.
- B. Respondent shall pay disgorgement of \$8.4 million, and has agreed to do so in a matter captioned *Serious Fraud Office v. Standard Bank Plc*, No., U20150854, Southwark Crown Court, United Kingdom (the "U.K. Matter"). Respondent's disgorgement obligation shall be deemed satisfied upon such payment. If Respondent makes payment of less than \$8.4 million in disgorgement in connection with the U.K. Matter, Respondent acknowledges that its disgorgement obligation will be credited up to the amount of the payment made by Respondent in the U.K. Matter, with the remaining balance due and payable to the Securities and Exchange Commission within 14 days of payment pursuant to the resolution of the U.K. Matter, or, if there is no payment of disgorgement pursuant in the resolution of the U.K.

Matter, within 14 days of a final order not ordering payment of disgorgement in the U.K. Matter.

- C. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$4.2 million to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717. A penalty amount that includes an additional \$4.2 million is appropriate for the conduct at issue here, however in consideration of the money penalty paid by Respondent in the U.K. Matter, no additional penalty is being ordered at this time.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Standard Bank Plc as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Gerald Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order

granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

By: \_\_\_\_\_  
Brent J. Fields  
Secretary

*Jill M. Peterson*  
By: Jill M. Peterson  
Assistant Secretary