

**Corrected to Conform to Federal Register Version**

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PART 242**

**[Release No. 34-60997; File No. S7-27-09]**

**RIN 3235-AK46**

**Regulation of Non-Public Trading Interest**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rules and amendments to joint-industry plans.

**SUMMARY:** The Securities and Exchange Commission (“Commission”) is proposing to amend the regulatory requirements of the Securities Exchange Act of 1934 (“Exchange Act”) that apply to non-public trading interest in National Market System (“NMS”) stocks, including so-called “dark pools” of liquidity. First, it is proposing to amend the definition of “bid” or “offer” in Exchange Act quoting requirements to apply expressly to actionable indications of interest (“IOIs”) privately transmitted by dark pools and other trading venues to selected market participants. The proposed definition would exclude, however, IOIs for large sizes that are transmitted in the context of a targeted size discovery mechanism. Second, the Commission is proposing amendments to the display obligations of alternative trading systems (“ATs”) in Regulation ATS under the Exchange Act, including a substantial lowering of the trading volume threshold in Regulation ATS that triggers public display obligations for ATs. Third, the Commission is proposing to amend the joint-industry plans for publicly disseminating consolidated trade data to require real-time disclosure of the identity of dark pools and other ATs on the reports of their executed trades. The proposals are intended to promote the Exchange Act goals of transparency, fairness, and efficiency.

**DATES:** Comments should be received on or before February 22, 2010.

**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.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. S7-27-09 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 in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File No. S7-27-09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for public inspection and copying 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; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

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## **SUPPLEMENTARY INFORMATION:**

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### **I. Introduction**

The Commission is proposing to amend the regulatory requirements of the Exchange Act that apply to non-public trading interest in NMS stocks,<sup>1</sup> including so-called “dark pools” of

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<sup>1</sup> Rule 600(b)(47) of Regulation NMS defines “NMS stock” to mean any NMS security other than an option. Rule 600(b)(46) defines “NMS security” to mean any security for which trade reports are made available pursuant to an effective transaction reporting plan. In general, NMS stocks are those that are listed on a national securities exchange.

liquidity. Such trading interest is considered non-public, or “dark,” primarily because it is not included in the consolidated quotation data for NMS stocks that is widely disseminated to the public.

Consolidated market data is the primary vehicle for public price transparency in the U.S. equity markets. It includes both: (1) pre-trade transparency – real-time information on the best-priced quotations at which trades may be executed in the future (“consolidated quotation data”); and (2) post-trade transparency – real-time reports of trades as they are executed (“consolidated trade data”).<sup>2</sup> The central processors for consolidated market data in NMS stocks collect quotation and trade information from the relevant self-regulatory organizations (“SROs”) – the equity exchanges and the Financial Industry Regulatory Authority (“FINRA”) – and distribute the information in a consolidated stream pursuant to joint-SRO plans. Rule 603(b) of Regulation NMS requires that consolidated market data for each NMS stock be disseminated through a single plan processor. Consolidated market data is designed to assure that the public has a single source of affordable, accurate, and reliable information on the best quoted prices and last sale prices for each NMS stock.<sup>3</sup>

In general, dark liquidity (that is, trading interest that is not included in the consolidated quotation data) is not a new phenomenon. Market participants that need to trade in large size, such as institutional investors, always have sought ways to minimize their transaction costs by completing their trades without prematurely revealing the full extent of their trading interest to

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<sup>2</sup> 17 CFR 242.603(b).

<sup>3</sup> The consolidated quotation data streams and their policy objectives are fully described in the Commission’s Concept Release on Regulation of Market Information Fees and Revenues. Securities Exchange Act Release No. 42208 (December 9, 1999), 64 FR 70613 (December 17, 1999) (“Market Information Concept Release”).

the broader market.<sup>4</sup> For many years, the manual trading floors of exchanges were a primary source of dark liquidity in the form of floor traders that “worked” the large orders of their customers, executing each such order in a number of smaller transactions without revealing to counterparties the total size of the order. In addition, broker-dealers acting as over-the-counter (“OTC”) market makers and block positioners long have provided liquidity directly to their customers that is not reflected in the consolidated quotation data. Moreover, Rule 604 of Regulation NMS, which imposes limit order display requirements, recognizes the need of large

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<sup>4</sup> The Commission previously has noted the interest of, and steps taken by, institutional investors to minimize the price impact of their trading:

Another type of implicit transaction cost reflected in the price of a security is short-term price volatility caused by temporary imbalances in trading interest. For example, a significant implicit cost for large investors (who often represent the consolidated investments of many individuals) is the price impact that their large trades can have on the market. Indeed, disclosure of these large orders can reduce the likelihood of their being filled. Consequently, large investors often seek ways to interact with order flow and participate in price competition without submitting a limit order that would display the full extent of their trading interest to the market. Among the ways large investors can achieve this objective are: (1) to have their orders represented on the floor of an exchange market; (2) to submit their orders to a market center that offers a limit order book with a reserve size feature; or (3) to use a trading mechanism that permits some form of “hidden” interest to interact with the other side of the market. A market structure that facilitates maximum interaction of trading interest can produce price competition within displayed prices by providing a forum for the representation of undisclosed orders.

Securities Exchange Act Release No. 42450 (February 23, 2000), 65 FR 10577, 10581 (February 28, 2000) (SR-NYSE-99-48) (“Concept Release on Market Fragmentation”) (citations omitted) (emphasis in original). The Commission also noted the harm that short-term volatility can cause to investors:

In theory, short-term price swings that hurt investors on one side of the market can benefit investors on the other side of the market. In practice, professional traders, who have the time and resources to monitor market dynamics closely, are far more likely than investors to be on the profitable side of short-term price swings (for example, by buying early in a short-term price rise and selling early before the price decline).

Id. at 10581 n. 26.

investors to control the public display of their trading interest. Rule 604(b)(4), for example, provides a general exception from the public display requirement for a block size order, unless the customer placing the order requests that the order be displayed.<sup>5</sup> In general, the Commission has sought over the years to promote the public display of trading interest by attempting to provide positive incentives for display, but has never sought to prohibit trading venues from offering dark liquidity services to investors.<sup>6</sup>

The term “dark pool” is not used in the Exchange Act or Commission rules. For purposes of this release, the term refers to ATSS that do not publicly display quotations in the consolidated quotation data. Although dark pools publicly report their executed trades in the consolidated trade data, the trade reports are not required to identify the particular ATS that executed the trade. In contrast, the trade reports of registered exchanges are required to identify the exchange that executed the trade and thereby provide more transparency about the location of liquidity in NMS stocks.<sup>7</sup>

In recent years, an increasing number of dark pools have organized to provide their customers with electronic access to dark liquidity trading services. The number of active dark pools trading NMS stocks has increased from approximately 10 in 2002 to approximately 29 in

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<sup>5</sup> Rule 600(b)(9) of Regulation NMS defines “block size” to mean an order of at least 10,000 shares; or for a quantity of stock having a market value of at least \$200,000.

<sup>6</sup> The Commission’s recently proposed amendment to Rule 602 of Regulation NMS to eliminate an exception for the use of “flash orders” reflects this approach. See Securities Exchange Act Release No. 60684 (September 18, 2009), 74 FR 48632 (September 23, 2009). Although flash orders are used to access dark liquidity, the concerns that prompted the Commission’s proposal relate to the use of the “flash” mechanism (that is, the dissemination of valuable order information to certain market participants rather than in the consolidated quotation data).

<sup>7</sup> See infra note 85 and accompanying text. See also the CTA Plan, Section VI(f) and the Nasdaq UTP Plan, Section VI(c)(3).

2009.<sup>8</sup> For the second quarter of 2009, the trading volume of these dark pools was approximately 7.2% of the total share volume in NMS stocks, with no individual dark pool executing more than 1.3%.<sup>9</sup> By way of comparison, no single registered securities exchange currently executes more than 19% of volume in NMS stocks.<sup>10</sup> Given this dispersal of volume among a large number of trading venues, dark pools with their 7.2% market share collectively represent a significant source of liquidity in NMS stocks.

The particular business models and trading mechanisms of dark pools can vary widely. For example, some dark pools, such as block crossing networks, offer specialized size discovery mechanisms that attempt to bring large buyers and sellers in the same NMS stock together anonymously and to facilitate a trade between them. The average trade size of these block crossing networks can be as high as 50,000 shares.<sup>11</sup> Most dark pools, though they may handle large orders, primarily execute trades with small sizes that are more comparable to the average

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<sup>8</sup> Data compiled from Forms ATS submitted to the Commission for 2d quarter 2009. Some trading venues, such as OTC market makers, offer dark liquidity primarily in a principal capacity and do not operate as ATSs. For purposes of this release, these trading venues are not defined as dark pools because they are not ATSs. These trading venues may, however, offer electronic dark liquidity services that are analogous to those offered by dark pools. If subject to the quoting requirements of Rule 602 of Regulation NMS, for example, an OTC market maker would be covered by the proposal to amend the definition of bid or offer to address actionable IOIs.

<sup>9</sup> Data compiled from Forms ATS submitted to the Commission for 2d quarter 2009.

<sup>10</sup> See, e.g., market volume statistics reported by BATS Exchange, Inc., available at [http://www.batstrading.com/market\\_summary](http://www.batstrading.com/market_summary) (no single national securities exchange executed more than 19.0% of volume in NMS stocks during 5-day period ending September 21, 2009).

<sup>11</sup> See, e.g., <http://www.liquidnet.com/about/liquidStats.html> (average U.S. execution size in July 2009 was 49,638 shares for manually negotiated trades via Liquidnet's negotiation product); <http://www.pipelinetrading.com/AboutPipeline/CompanyInfo.aspx> (average trade size of 50,000 shares in Pipeline).

size of trades in the public markets, which was less than 300 shares in August 2009.<sup>12</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 trading volume.<sup>13</sup>

The emergence of dark pools as a significant source of liquidity for NMS stocks raises a variety of important policy issues that deserve serious consideration. In this regard, the Commission has undertaken a broad review of equity market structure to assess its performance in recent years and whether market structure rules have kept pace with, among other things, changes in trading technology and practices. To help facilitate its review, the Commission intends to consider in the near future whether to publish a concept release requesting comment and data on a wide range of market structure topics. These likely would include the benefits and drawbacks of dark liquidity in all its forms, including dark pools, the order flow arrangements of OTC market makers, and undisplayed orders on exchanges.

The proposals in this release accordingly do not attempt to address all of the issues regarding dark liquidity. The proposals instead address three issues with respect to dark liquidity that the Commission preliminarily believes warrant attention, are sufficiently discrete, and as to which the Commission has sufficient information to proceed with a proposal.

One such issue arises from the messages, often called IOIs, that some dark pools privately transmit to selected market participants concerning their actionable orders in NMS stocks. As discussed further in section II below, these actionable IOIs are intended to attract immediately executable order flow to the trading venue, and, in this sense, they function quite

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<sup>12</sup> See, e.g., <http://www.nasdaqtrader.com/trader.aspx?id=marketshare> (average size of NASDAQ matched trades in July 2009 was 228 shares); <http://nyxdata.com/nysedata/asp/factbook> (NYSE Group average trade size in all stocks traded in July 2009 was 267 shares).

<sup>13</sup> Data compiled from Forms ATS submitted to Commission for 2d quarter 2009.



similarly to displayed quotations. As a result, dark pools that distribute actionable IOIs are no longer completely dark on a pre-trade basis. Rather, they are “lit” to a select group of market participants and dark with respect to the rest of the public. By privately transmitting valuable order information concerning the best prices for NMS stocks to selected market participants, actionable IOIs create the potential for two-tiered access to information, something that has long been a serious concern of the Commission.<sup>14</sup> It therefore is proposing two initiatives that would address this concern.

First, the Commission is proposing to amend the definition of “bid” or “offer” in Rule 600(b)(8) of Regulation NMS to apply explicitly to actionable IOIs. This definition of bid or offer is a key element that determines the public quoting requirements of exchanges and OTC market makers under Rule 602 of Regulation NMS, as well as ATs under Rule 301(b) of Regulation ATS. In this respect, the revised definition would apply equally to all types of trading venues and help promote fair competition among them. Importantly, however, the proposed definition of bid or offer would recognize the need for targeted size discovery mechanisms that can enable investors to trade more efficiently in sizes much larger than the average size of trades in the public markets.<sup>15</sup> Specifically, the proposed amendment to the definition would exclude any actionable IOIs “for a quantity of NMS stock having a market value of at least \$200,000 that are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000” (“size-discovery IOIs”).<sup>16</sup>

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<sup>14</sup> See infra note 59 and accompanying text.

<sup>15</sup> See supra note 12 (average size of trades in public markets is less than 300 shares). The market value of a 300 share order in a \$30 stock is \$9000.

<sup>16</sup> For purposes of this release, the term “size discovery IOIs” means IOIs that qualify for the proposed exclusion for certain IOIs with large size. The term “actionable IOIs” means any actionable IOI other than size discovery IOIs.

As a second initiative to address actionable IOIs, the Commission is proposing to lower substantially the trading volume threshold in Rule 301(b) of Regulation ATS that triggers the obligation for ATSs to display their best-priced orders in the consolidated quotation data. Currently, an ATS is not required to include its best-priced orders for an NMS stock in the consolidated quotation data (even if it widely disseminates such orders) when its trading volume in that NMS stock is less than 5%.<sup>17</sup> Similarly, many, if not all, dark pools that transmit actionable IOIs would not be required to include this actionable order information in the consolidated quotation data if the Regulation ATS display threshold remains at 5%. The Commission is proposing to lower the volume threshold to 0.25% to help assure that the public, through the consolidated quotation data, has access to valuable order (including actionable IOI) information about the best prices and sizes for NMS stocks that trade on an ATS.

The practical result of the proposed amendment to the definition of bid or offer and the proposed lowering of the ATS volume threshold would be that ATSs could not privately display actionable IOIs only to select market participants and thereby create two-tiered access to information on the best available prices for NMS stocks. In addition, by lowering the trading volume threshold, more ATS quotes would be made available to the public by requiring their inclusion in the consolidated quotation data. As discussed below, the Commission preliminarily believes that this result would enhance price transparency and promote fairer and more efficient markets.

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<sup>17</sup> Those ATSs that operate as electronic communication networks (“ECNs”) and qualify for the ECN display alternative under Rule 602(b)(5)(ii) voluntarily have chosen to include their best-priced orders in the consolidated quotation data even when their volume in an NMS stock is less than 5%. The proposed amendments to Regulation ATS would not affect the display practices of these ECNs.

Finally, the Commission is proposing an initiative to improve the post-trade transparency of dark pools and other ATSS. As ATSS that trade in the OTC market, dark pools must be members of FINRA, and they are required to report their trades to FINRA for inclusion in the consolidated trade data. These trade reports do not, however, identify the particular venue that executed the trade, unlike the trade reports of registered exchanges.<sup>18</sup> To address this information gap, the Commission is proposing to amend the joint-SRO plans for publicly disseminating consolidated trade data to require real-time disclosure of the identity of ATSS on the reports of their executed trades. The proposal is designed to improve the quality of information about sources of liquidity in NMS stocks, as well as to increase public confidence in the integrity of the U.S. equity markets.<sup>19</sup>

## **II. Actionable IOIs**

### **A. Concerns About Actionable IOIs**

In recent years, a number of dark pools have begun to transmit IOIs to selected market participants that convey substantial information about their available trading interest.<sup>20</sup> These

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<sup>18</sup> See *infra* note 85 and accompanying text. ATSS are broker-dealers that have chosen to comply with Regulation ATS and thus are exempt from the statutory definition of “exchange.” 17 CFR 240.3a1-1(a)(2).

<sup>19</sup> See, e.g., Securities Exchange Act Release No. 30569 (April 10, 1992), 57 FR 13396, 13398-13399 (April 16, 1992) (discussing benefits of transparency to the operation of fair and efficient capital markets).

<sup>20</sup> Data compiled from Forms ATS submitted to the Commission for 2d quarter 2009 suggest that approximately 11 of 29 active dark pools in NMS stocks use some form of IOI. See also Peter Chapman and Nina Mehta, 2008 Review: IOIs Expand and Do More Heavy Lifting, Traders Magazine (December 2008) (“The year just passed witnessed the transformation of the indication of interest. Long a plain vanilla communication tool between the sellside and the buy-side, the IOI is being reinvented to meet the requirements of a new era of trading.”); John Hintz, Institutions and Sell Side Alike Grapple with Impact of IOIs, Securities Industry News, September 8, 2008 (“The dozens of dark pools that have emerged in recent years have each sought to offer unique features to draw order flow and increase fill rates. But some of the platforms’ “special sauce” may make them less than fully dark.”).

messages are not included in the consolidated quotation data, although, like displayed quotations, they can be significant inducements for the routing of orders to a particular trading venue.

Indeed, some exchanges, when they do not have available trading interest to execute orders at the best displayed prices, give participants a choice of routing their orders to undisplayed venues in response to IOIs rather than to public markets in response to the best displayed quotations.<sup>21</sup>

Although these IOIs may not explicitly specify the price and size of available trading interest at the dark pool, the practical context in which they are transmitted renders them “actionable” – that is, the messages effectively alert the recipient that the dark pool currently has trading interest in a particular symbol, side (buy or sell), size (minimum of a round lot of trading interest), and price (equal to or better than the national best bid for buying interest and the national best offer for selling interest).

For example, a dark pool may send an IOI to a group of market participants communicating an interest in buying a specific NMS stock. Given that Rule 611 of Regulation NMS generally prevents trading centers, including dark pools, from executing orders at prices inferior to the national best bid or offer (“NBBO”), the IOI recipient reasonably can assume that the price associated with the IOI is the NBBO or better. Moreover, the IOI may be part of a course of conduct in which the recipient has responded with orders to the sender and repeatedly

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<sup>21</sup> See, e.g., NYSE Arca, “Client Notice: NYSE Arca to Provide Indication of Interest (IOI) Routing” (March 12, 2008) (routing service for “non-displayed liquidity pools”); Rob Curran, NYSE, Nasdaq Expanding Roles as ‘Dark Pools’ Converge, Dow Jones News Service (June 13, 2008) (“Only if the dark-pool partners give an indication they may have a better price on the security will Nasdaq route an order there.”); Nina Mehta, Arca Beats Nasdaq to Dark Pools, Traders Magazine Online News, March 14, 2008 (“Now, after a marketable order checks Arca’s book for liquidity, it passes through what [Arca executive] calls a ‘cloud’ of electronic indications from as many as 29 dark pools (not all are online yet). The order executes against indications pooled in the cloud before being routed to protected quotes on other markets. Customers that execute against the cloud are guaranteed NBBO-or-better executions.”).

received executions at the NBBO or better with a size of at least one round lot. With this information (both explicit and implicit), the recipient of the IOI can reasonably conclude that sending a contra-side marketable order<sup>22</sup> responding to the IOI will result in an execution if the dark pool trading interest has not already been executed against or cancelled. In this respect, actionable IOIs are functionally quite similar to displayed quotations at the NBBO.

The order information communicated by actionable IOIs can be extremely valuable. Actionable IOIs with prices (whether explicit or implicit) better than the NBBO would effectively narrow the quoted spread for an NMS stock, if included in the consolidated quotation data. For example, if the NBBO for an NMS stock were \$20.10 and \$20.14, an actionable IOI to buy with a price of \$20.12 would, if included in the consolidated quotation data, create a new NBBO of \$20.12 and \$20.14 and thereby reduce the quoted spread by 50%. Reducing quoted spreads is important not only for those that trade with the displayed quotations, but also for other investors, including those whose orders are routed to OTC market makers for executions that often are derived from NBBO prices.<sup>23</sup> In addition, actionable IOIs with prices (whether explicit or implicit) equal to the NBBO could substantially improve the quoted depth at the best prices for an NMS stock. For example, an investor may wish to sell 500 shares of a stock when the size of the national best bid may be only 100 shares. The existence of multiple dark pools that contemporaneously had transmitted actionable IOIs to buy the stock would represent a substantial increase in the available size at NBBO prices or better.

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<sup>22</sup> A “marketable” order is priced so that it is immediately executable at the best displayed quotations (that is, a buy order priced at the national best offer or higher and a sell order priced at the national best bid or lower).

<sup>23</sup> See, e.g., Concept Release on Market Fragmentation, supra note 4, at 10582-10583 (discussing broker-dealer internalization and noting that “a market maker with access to directed order flow often may merely match the displayed prices of other market centers and leave the displayed interest unsatisfied”).

The public, however, does not have access to this valuable information concerning the best prices and sizes for NMS stocks. Rather, dark pools transmit this information only to selected market participants. In this regard, actionable IOIs can create a two-tiered level of access to information about the best prices and sizes for NMS stocks that undermines the Exchange Act objectives for a national market system.<sup>24</sup> The consolidated quotation data is intended to provide a single source of information on the best prices for a listed security across all markets, rather than force the public to obtain data from many different exchanges and other markets to learn the best prices.<sup>25</sup> This objective is not met when dark pools or other trading venues disseminate information that is functionally quite similar to quotations, yet is not included in the consolidated quotation data.

The Commission also is concerned that the private use of actionable IOIs may discourage the public display of trading interest and reduce quote competition among markets. The Commission long has emphasized the need to encourage displayed liquidity in the form of publicly displayed limit orders.<sup>26</sup> Such orders establish the current “market” for a stock and thereby provide a critical reference point for investors. Actionable IOIs, however, often will be executed by dark pools at prices that match the best displayed prices for a stock at another

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<sup>24</sup> See infra note 59 and accompanying text.

<sup>25</sup> See 17 CFR 242.603(b) (providing for the distribution of all consolidated information for an individual NMS stock through a single plan processor).

<sup>26</sup> See, e.g., Securities Exchange Release No. 51808 (June 9, 2005), 70 FR 37496, 37527 (June 29, 2005) (“NMS Release”) (“The Commission believes, however, that the long-term strength of the NMS as a whole is best promoted by fostering greater depth and liquidity, and it follows from this that the Commission should examine the extent to which it can encourage the limit orders that provide this depth and liquidity to the market at the best prices.”); Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290, 48293 (September 12, 1996) (“Order Handling Rules Release”) (“[T]he display of customer limit orders advances the national market system goal of the public availability of quotation information, as well as fair competition, market efficiency, best execution, and disintermediation.”).

market. In this respect, actionable IOIs at NBBO matching prices potentially deprive those who publicly display their interest at the best price from receiving a speedy execution at that price. The opportunity to obtain the fastest possible execution at a price is the primary incentive for the display of trading interest.<sup>27</sup> Particularly if actionable IOIs continued to expand in trading volume, they could significantly undermine the incentives to display limit orders and to quote competitively, thereby detracting from the efficiency and fairness of the national market system.

Moreover, for market participants that wish to supply liquidity in the form of non-marketable resting orders (such as those that match or improve NBBO prices), actionable IOIs provide a tool to achieve this result without displaying quotations publicly. The availability of these private messages as an alternative means to attract order flow may reduce the incentives of market participants to quote publicly. More generally, actionable IOIs divert a certain amount of order flow that otherwise might be routed directly to execute against displayed quotations in other markets.<sup>28</sup> Given the importance of displayed quotations for market efficiency, the Commission is particularly concerned about additional marketable order flow that may be diverted from the public quoting markets and that could further reduce the incentives for the public display of quotations.

## **B. Description of Proposal**

To address these concerns, the Commission is proposing to amend the Exchange Act quoting requirements to apply expressly to actionable IOIs. In particular, it is proposing to amend the definition of “bid” or “offer” in Rule 600(b)(8) of Regulation NMS. “Bid” and “offer” are key terms that determine the scope of the two primary rules that specify the types of

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<sup>27</sup> See NMS Release, supra note 26, at 37505.

<sup>28</sup> See supra note 21 and accompanying text.

trading interest that must be included in the consolidated quotation data: Rule 602 of Regulation NMS and Rule 301(b)(3) of Regulation ATS.

Rule 602 of Regulation NMS specifies the public quoting requirements of national securities exchanges, national securities associations (currently, FINRA is the only national securities association that is subject to Rule 602), exchange members, and OTC market makers. In general, Rule 602 requires exchange members and certain OTC market makers to provide their best-priced bids and offers to their respective exchanges or FINRA.<sup>29</sup> The exchanges and FINRA, in turn, are required to make their best bids and offers available in the consolidated quotation data.<sup>30</sup>

Rule 600(b)(8) of Regulation NMS currently defines “bid” or “offer” to mean “the bid price or the offer price communicated by a member of a national securities exchange or member of a national securities association to any broker or dealer, or to any customer, at which it is willing to buy or sell one or more round lots of an NMS security, as either principal or agent, but shall not include indications of interest.”<sup>31</sup> This exclusion of IOIs was part of the definition of bid or offer when it was originally drafted in 1978 for inclusion in the predecessor of Rule 602.<sup>32</sup>

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<sup>29</sup> Under the definition of “subject security” in Rule 600(b)(73)(ii)(A) of Regulation NMS, an OTC market maker is not required to provide its best bids and offers for an NMS stock if the executed volume of the firm during the most recent calendar quarter comprised one percent or less of the aggregate trading volume for such NMS stock.

<sup>30</sup> 17 CFR 242.603(b).

<sup>31</sup> 17 CFR 242.600(b)(8) (emphasis added).

<sup>32</sup> Securities Exchange Act Release No. 14415 (January 26, 1978), 43 FR 4342 (February 1, 1978) (“The terms “bid” or “offer” shall mean the bid price or the offer price most recently communicated by an exchange member or third market maker to any broker or dealer, or to any customer, at which he is willing to buy or sell a particular amount of a reported security, as either principal or agent, but shall not include indications of interest.”).



In the adopting release, the term “indication of interest” was not defined, discussed, or expressly limited to a non-actionable communication of trading interest.

Rule 301(b)(3) of Regulation ATS specifies the order display and access requirements of ATSs.<sup>33</sup> When an ATS exceeds a 5% trading volume threshold in an NMS stock, the ATS is required to provide its best-priced orders to an exchange or association for inclusion in the consolidated quotation data made available under Rule 602. The term “order” is defined in Rule 300(e) of Regulation ATS to 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.”<sup>34</sup> This definition of “order” therefore includes, but is not limited to, “bid or offer quotations.” Although Regulation ATS does not define the term “bid or offer quotation,” the Commission considers it to have the same meaning as the terms “bid” or “offer” in Rule 600(b)(8) of Regulation NMS.<sup>35</sup>

When Regulation ATS was adopted in 1998, the Commission addressed the issue of whether IOIs were covered by the term “order” in the context of whether an IOI was “firm” or “non-firm.” It noted that “[w]hether or not an indication of interest is ‘firm’ will depend on what actually takes place between a buyer or seller. The label put on an order – ‘firm’ or ‘non-firm’ – is not dispositive.”<sup>36</sup> The Commission further stated that “a system that displays bona fide, non-firm indications of interest – including, but not limited to, indications of interest to buy or sell a

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<sup>33</sup> The requirements for ATS order display and access are discussed in section III below.

<sup>34</sup> 17 CFR 242.300(e) (emphasis added).

<sup>35</sup> Rule 600(b)(62) of Regulation NMS defines “quotation” to mean “a bid or an offer.”

<sup>36</sup> Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844, 70850 (December 22, 1998) (“Regulation ATS Adopting Release”). The discussion in the Regulation ATS Adopting Release specifically referenced the definition of “order” in Rule 3b-16(c) under the Exchange Act, which is relevant for purposes of the meaning of “exchange.” Rule 3b-16 was adopted at the same time as Regulation ATS, and their definitions of “order” are the same.

particular security without either prices or quantities associated with those indications – will not be displaying ‘orders’ . . . Nevertheless, the price or size of an indication of interest may be either explicit or may be inferred from the facts and circumstances accompanying the indication.”<sup>37</sup> The Regulation ATS Adopting Release also noted that the definition of order was “intended to be broader than the terms bid and offer in [the predecessor of Rule 602].”<sup>38</sup>

The Commission preliminarily believes that the quoting requirements of both Rule 602 and Regulation ATS should clearly cover actionable IOIs. It therefore is proposing to amend the definition of “bid” or “offer” in Rule 600(b)(8) by expressly limiting its exclusion of IOIs to those “that are not actionable.” For example, an IOI would be considered actionable under the proposal if it explicitly or implicitly conveys all of the following information about available trading interest at the IOI sender: (1) symbol; (2) side (buy or sell); (3) a price that is equal to or better than the NBBO (the national best bid for buy orders and the national best offer for sell orders); and (4) a size that is at least equal to one round lot. In determining whether or not an IOI conveys this information, all of the facts and circumstances surrounding the IOI should be considered, including the course of dealing between the IOI sender and the IOI recipient.<sup>39</sup>

Under the proposal, when a quoting obligation under Rule 602 or Rule 301(b)(3) is triggered by the sending of an actionable IOI (i.e., sending an actionable IOI would be the communicating or displaying of a bid or an offer), the IOI sender would be considered a quoting venue and subject to the quoting requirements that generally apply to that type of venue, whether it be an exchange, an OTC market maker, or an ATS. These requirements would include, for example, restrictions on the display of locking or crossing quotations under Rule 610(d) of

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<sup>37</sup>

Id.

<sup>38</sup>

Id.

<sup>39</sup>

See supra note 36 and accompanying text.

Regulation NMS. In addition, the IOI sender would be required to reflect accurate information about the underlying order or other trading interest in the consolidated quotation data. This required order information would include the specific limit price and size of the underlying order or other trading interest.<sup>40</sup> The IOI sender also would be required to update the information as necessary, for example, to reflect executions or cancellations of the underlying order. Of course, customers of the dark pool would remain free, as they are entitled to do with quoting venues today, to control the release of their buying or selling interest.<sup>41</sup> Customers could not, however, consent to the dissemination of information sufficient for the transmission of an actionable IOI, yet withhold this information from the consolidated quotation data that is made available to the public.<sup>42</sup>

The Commission recognizes that some trading venues, such as block crossing networks, may use actionable IOIs as part of a trading mechanism that offers significant size discovery benefits (that is, finding contra-side trading interest for large size without affecting prices). These benefits may be particularly valuable for institutional investors that need to trade efficiently in sizes much larger than those that are typically available in the public quoting markets. These size discovery mechanisms could be rendered unworkable, however, if their

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<sup>40</sup> See, e.g., 17 CFR 242.301(b)(3)(ii) (requiring ATSs to provide the best prices and sizes of orders at the highest buy price and the lowest sell price for such NMS stock).

<sup>41</sup> Rule 604 of Regulation NMS, for example, explicitly recognizes the ability of customers to control whether their limit orders are displayed to the public. Rule 604(b)(2) provides an exception from the limit order display requirement for orders that are placed by customers who expressly request that the order not be displayed. Rule 604(b)(4) provides an exception for all block size orders unless the customer requests that the order be displayed.

<sup>42</sup> In addition, the Commission notes that existing Rule 301(b)(10) of Regulation ATS, 17 CFR 242.301(b)(10), requires an ATS to establish adequate safeguards and procedures to protect subscribers' confidential trading information. To meet this requirement, an ATS that markets itself as a dark pool, yet sends IOIs to third parties regarding subscriber orders, should adequately explain its use of IOIs to its subscribers.

narrowly targeted IOIs for large size were required to be included in the consolidated quotation data. Accordingly, the Commission is proposing a further amendment to the current definition of “bid” or “offer” in Rule 600(b)(8) to exclude any IOIs “for a quantity of NMS stock having a market value of at least \$200,000 that are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000.”

The purpose of this proposed exception for a targeted size discovery mechanism is to provide an opportunity for block crossing networks and other trading venues to offer new ways for investors that need to trade in large size to find contra-side trading interest of equally large size. The \$200,000 figure is taken from the definition of “block size” in Rule 600(b)(9) of Regulation NMS, which covers orders of at least 10,000 shares or for a quantity of stock having a market value of \$200,000. The Commission does not believe, however, that the 10,000 share alternative in the block size definition would be appropriate for the proposed size discovery exclusion from the definition of bid or offer, particularly with respect to low-priced stocks. For example, the market value of an IOI for 10,000 shares of a stock priced at \$3 per share is only \$30,000. To assure that the proposed size discovery exclusion would be limited to truly large size orders, the Commission is proposing to limit the exception to IOIs with a market value of at least \$200,000.

### **C. Request for Comments**

The Commission seeks comment and data on all aspects of the proposed amendment of the definition of bid or offer in Rule 600(b)(8) to apply expressly to actionable IOIs. Would the proposal promote the transparency, fairness, and efficiency of the national market system? Would it promote fair competition among trading venues in NMS stocks? Do commenters believe that the Commission has provided sufficient information about the attributes of an

actionable IOI for trading venues to comply? Should the rule text include an express definition of "actionable IOI," and, if so, what should it be? For example, should rule text incorporate the elements discussed above (symbol, side, price, and size), as well as a facts and circumstances analysis? Would an express definition be sufficient to address the full range of the policy concerns the Commission identifies in this release and prevent circumvention by market participants? Do actionable IOIs offer significant benefits for market participants that could not be realized if they were defined as bids or offers for purposes of Rule 602 of Regulation NMS and Rule 301(b) of Regulation ATS? If so, could similar benefits be achieved through other means? What is the typical size of an actionable IOI? How many large orders use actionable IOIs? What is the amount of order flow that is diverted from displayed quotations due to actionable IOIs? Please quantify and provide supporting data if possible.

Comment also is requested on the proposed size discovery exclusion from the definition of bid or offer. Would the proposed exclusion promote more efficient trading for investors that need to trade in large size? Is the exclusion narrowly drafted to cover those trading mechanisms that offer valuable size discovery benefits without inappropriately excluding trading interest concerning the best prices and sizes for NMS stocks from the consolidated quotation data? Comment also is requested on whether market value is the appropriate criterion for size, and whether \$200,000 is the appropriate figure. Should this figure be higher or lower? Please explain why. For example, is the \$200,000 figure appropriate for high-priced stocks? Should the exclusion include a size criterion based on number of shares? If yes, should it be 10,000 shares, as in Rule 600(b)(9), or a larger or smaller number of shares? Finally, comment is requested on whether other criteria for size, such as percentage of average daily share volume in a security, would be more appropriate.

### **III. ATS Display Obligations**

The Commission is also proposing certain amendments to Regulation ATS.<sup>43</sup> In conjunction with the Commission's proposed amendments to the definition of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS, the proposed amendments to Regulation ATS would seek to further integrate the best-priced orders available on ATSs into the national market system by revising the order display requirements in Rule 301(b)(3) of Regulation ATS.<sup>44</sup> Specifically, the Commission is proposing to amend Rule 301(b)(3)(i)(B) of Regulation ATS<sup>45</sup> to reduce the average daily trading volume threshold, that would trigger the order display and execution access requirements for an ATS, from 5% to 0.25%. The Commission is also proposing to amend Rule 301(b)(3)(ii) of Regulation ATS<sup>46</sup> to clarify that an ATS must publicly display and provide access to its best-priced orders in NMS stocks when such orders are displayed to more than one person (other than ATS employees), regardless of whether such persons are subscribers of the ATS. Finally, the Commission is proposing to amend Rule 301(b)(3) to parallel the proposed size discovery exclusion from the definition of "bid" or "offer" discussed in section II above.

#### **A. Lowering the Threshold for Display Requirement**

Rule 301(b)(3) of Regulation ATS imposes certain order display and execution access obligations on ATSs. Currently, the obligations apply to any ATS that "(A) displays subscriber orders to any person (other than alternative trading system employees); and (B) during at least 4 of the preceding 6 calendar months, had an average trading volume of 5 percent or more of the aggregate average daily share volume for [an] NMS stock as reported by an effective transaction

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<sup>43</sup> 17 CFR 242.300 et seq.

<sup>44</sup> 17 CFR 242.301(b)(3).

<sup>45</sup> 17 CFR 242.301(b)(3)(i)(B).

<sup>46</sup> 17 CFR 242.301(b)(3)(ii).

reporting plan."<sup>47</sup> If an ATS meets these criteria, it is required to comply with Rule 301(b)(3)(ii),<sup>48</sup> which requires the ATS to provide to a national securities exchange or national securities association (each of which is a "self-regulatory organization" or "SRO") the prices and sizes of the orders at the highest buy price and the lowest sell price for that NMS stock, displayed to more than one subscriber of the ATS, for inclusion in the quotation data made available by the SRO to vendors. An ATS that meets the volume threshold also is required to comply with Rule 301(b)(3)(iii), which sets forth certain access standards regarding the orders that the ATS is required to provide to an SRO pursuant to Rule 301(b)(3)(ii).

The Commission is proposing to amend Rule 301(b)(3)(i)(B) by reducing the average daily trading volume threshold from 5% to 0.25%. Thus, under the proposed amendment, the display and access requirements of Rules 301(b)(3)(ii) and 301(b)(3)(iii), respectively, would apply if the ATS's average daily volume in an NMS stock were 0.25% or more during at least four of the preceding six calendar months. Average daily trading volume would continue to be based on volumes reported by an effective transaction reporting plan.

The Commission preliminarily believes that lowering the volume threshold would further the goals of the national market system by reducing the potential for two-tiered markets and improving the quality of quotation data made available to the public. As discussed above, the Commission is proposing to amend the definitions of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS in a manner that would, among other things, make these sections consistent with the Commission's policy statements in adopting Regulation ATS that actionable IOIs are orders for purposes of that regulation.<sup>49</sup>

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<sup>47</sup> 17 CFR 242.301(b)(3)(i).

<sup>48</sup> 17 CFR 242.301(b)(3)(ii).

<sup>49</sup> See supra note 36 and accompanying text.

The Commission believes that broker-dealers operating ATSS should be subject to quoting requirements that broadly parallel those applicable to other market participants. Currently, the order display and execution access requirements in Regulation ATS do not apply to an ATS unless, among other things, the ATS has an average daily trading volume in an NMS stock of 5% or more. Few if any dark pool ATSS exceed the 5% threshold for any NMS stocks although, as explained above,<sup>50</sup> ATSS collectively account for a significant share of trading volume. Many dark pool ATSS communicate order information via actionable IOIs that could, if appropriately integrated, contribute to the overall efficiency and quality of the national market system. Without any attendant change to Regulation ATS to lower the 5% threshold, the proposed amendments to the definitions of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS would have less effect, because most ATSS could remain under the 5% threshold and thus continue to communicate actionable IOIs only to selected market participants. Therefore, in conjunction with the proposed amendments to Rule 600(b)(8), the Commission is proposing to substantially lower the threshold at which an ATS incurs an obligation under Regulation ATS to provide orders to an SRO for inclusion in the public quote stream. The Commission preliminarily believes that such amendment would be consistent with the mandate set forth in Section 11A of the Exchange Act<sup>51</sup> to promote a national market system.

Congress in 1975 endorsed the development of a national market system and granted the Commission broad authority to implement it.<sup>52</sup> Chief among the objectives of the national market system are coordinating markets, reducing fragmentation, and limiting the possibility of tiered markets where the best trading opportunities are available only to selected market

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<sup>50</sup> See supra notes 9 and 10 and accompanying text.

<sup>51</sup> 15 U.S.C. 78k-1.

<sup>52</sup> See Pub. L. 94-29, 89 Stat. 97 (1975) (adopting Section 11A of the Exchange Act).



participants.<sup>53</sup> As the Commission has long recognized, proper coordination of markets requires transparency and access across the national market system.<sup>54</sup> Market participants must be able to know where the best trading opportunities exist, and have the ability to execute orders in response to those opportunities. The Commission has taken a number of actions designed to further these goals,<sup>55</sup> such as by providing, through Regulation ATS, a regulatory framework that promotes competition among and innovation by exchange and non-exchange trading centers while attempting to minimize detrimental market fragmentation. As the Commission observed in 1997, the failure "to fully coordinate trading on alternative trading systems into national market systems mechanisms has impaired the quality and pricing efficiency of secondary equity markets. . . . Although these systems are available to some institutions, orders on these systems frequently are not available to the general investing public."<sup>56</sup> The Commission noted that such

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<sup>53</sup> See 15 U.S.C. 78k-1(a)(1)(D) ("The linking of all markets for qualified securities through communication and data procession facilities will foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate the offsetting of investors' orders, and contribute to best execution of such orders"). See also Securities Exchange Act Release No. 39884 (April 21, 1998), 63 FR 23504, 23514 (April 29, 1998) ("Regulation ATS Proposing Release"); Securities Exchange Act Release No. 38672 (May 23, 1997), 62 FR 30485, 30492 (June 4, 1997) ("Concept Release") (citing *inter alia* SEC, STATEMENT OF THE SECURITIES AND EXCHANGE COMMISSION ON THE FUTURE STRUCTURE OF THE SECURITIES MARKETS (February 2, 1972), 37 FR 5286 (March 14, 1972)); Securities Exchange Act Release No. 36310 (September 29, 1995), 60 FR 52792 (October 10, 1995).

<sup>54</sup> See, e.g., Regulation ATS Proposing Release, *supra* note 53, 63 FR at 23511.

<sup>55</sup> See, e.g., Rules 610 and 611 of Regulation NMS, 17 CFR 242.610 and 242.611; Order Handling Rules Release, *supra* note 26 and accompanying text. See also H.R. Rep. 94-123, 94th Cong., 1st Sess. 50 (1975) (concluding that "Investors must be assured that they are participants in a system which maximizes the opportunities for the most willing seller to meet the most willing buyer").

<sup>56</sup> Concept Release, *supra* note 53, 63 FR at 30492. See also Regulation ATS Proposing Release, *supra* note 53, 63 FR at 23514.

"hidden markets" – where superior quotations might be available to a subset of market participants – impeded the goals of the national market system.<sup>57</sup>

Later, when adopting Regulation ATS in 1998, the Commission stated that "it is inconsistent with congressional goals for a national market system if the best trading opportunities are made accessible only to those market participants who, due to their size or sophistication, can avail themselves of prices in alternative trading systems. The vast majority of investors may not be aware that better prices are disseminated to alternative trading system subscribers and many do not qualify for direct access to these systems and do not have the ability to route their orders, directly or indirectly, to such systems. As a result, many customers, both institutional and retail, do not always obtain the benefit of the better prices entered into an alternative trading system."<sup>58</sup> The Commission further stated that, "in light of the significant trading volume on some alternative trading systems, integration of institutional and non-market maker broker-dealer orders into the national market system is essential to prevent the development of a two-tiered market."<sup>59</sup> Beyond the general benefits of such integration, the Commission specifically noted that "prices displayed only on alternative trading systems are

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<sup>57</sup> See Regulation ATS Proposing Release, supra note 53, 63 FR at 23514-15 ("The use of these systems to facilitate transactions in securities at prices not incorporated into the [national market system] has resulted in fragmented and incomplete dissemination of quotation information. Recent evidence suggests that the failure of the current regulatory approach to fully integrate trading on alternative trading systems into [the national market system] mechanisms has impaired the quality and pricing efficiency of secondary equity markets, particularly in light of the explosive growth in trading volume on such alternative trading systems").

<sup>58</sup> Regulation ATS Adopting Release, supra note 36, 63 FR at 70865.

<sup>59</sup> Id. at 70866.

immediately known to key market players who can adjust their trading to take advantage of their information advantage."<sup>60</sup>

While initially proposing a 10% threshold,<sup>61</sup> the Commission ultimately adopted a 5% threshold. As noted in the Regulation ATS Adopting Release: "The Commission believes that lowering the threshold to five percent will provide more benefits to investors, promote additional market integration, and further discourage two-tier markets. At the same time, the Commission believes that those alternative trading systems with less than five percent of the volume would not add sufficiently to transparency to justify the costs associated with linking to a market."<sup>62</sup> The Commission continues to have the same concerns about fragmentation, two-tiered markets, and lack of transparency potentially caused by ATSs as it did when adopting Regulation ATS. However, as explained below, it now preliminarily believes that the 5% threshold for triggering ATS display obligations is too high, and that developments in technology, communications, and market structure warrant a substantial reduction of the ATS display threshold, to 0.25%.

Since the Commission adopted Regulation ATS, the equity markets have evolved significantly and trading activity has become substantially less concentrated. The market shares of major national securities exchanges have declined over the last several years.<sup>63</sup> More recently adopted national market system rules require robust intermarket linkages and protection of best-

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<sup>60</sup> Id. at 70869. See also Order Handling Rules Release, supra note 26, 61 FR at 48308 ("[T]he ECN amendment is intended to integrate into the public quote the prices of market makers and specialists that are now widely disseminated to ECN subscribers but are not available to the rest of the market").

<sup>61</sup> See Regulation ATS Proposing Release, supra note 53, 63 FR at 23515.

<sup>62</sup> Regulation ATS Adopting Release, supra note 36, 63 FR at 70867.

<sup>63</sup> See supra notes 9 and 10 and accompanying text.

priced quotations.<sup>64</sup> As noted above,<sup>65</sup> a large number of ATSS operating as dark pools have commenced operations and collectively represent a significant source of liquidity for NMS stocks. Many dark pool ATSS send actionable IOIs regarding subscriber orders held in their systems. Such actionable IOIs typically represent orders that are at or inside the NBBO, which – if incorporated into the public quote stream – could substantially benefit the national market system by, among other things, providing additional liquidity and promoting vigorous price competition between orders and between markets.

Because the number of trading centers has increased and the concentration of trading activity has become more dispersed, even smaller trading centers can now, collectively, have a substantial impact on price discovery for the overall market. For this reason, the Commission preliminarily believes that, to maintain a fair and efficient national market system, the majority of information about orders in NMS stocks communicated by ATSS to selected market participants – whether via actionable IOIs or otherwise – should participate in the public price discovery process. To accomplish this goal, the Commission is proposing to substantially lower the trading volume threshold in Rule 301(b)(3) of Regulation ATS. At the same time, consistent with the goals it articulated in adopting Regulation ATS,<sup>66</sup> the Commission continues to believe that competition is important to a successful national market system, and that ATSS help promote

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<sup>64</sup> See, e.g., Rules 610 and 611 of Regulation NMS, 17 CFR 242.610 and 242.611; NMS Release, supra note 26, 70 FR at 37501-37503 (summary of basis for requirements).

<sup>65</sup> See supra notes 8-10 and accompanying text.

<sup>66</sup> See Regulation ATS Adopting Release, supra note 36, 63 FR at 70846-47 ("The final rules seek to establish a regulatory framework that makes sense both for current and future securities markets. This regulatory framework should encourage market innovation while ensuring basic investor protections. . . . The Commission believes the framework it is adopting meets the varying needs and structures of market participants and is flexible enough to accommodate the business objectives of, and the benefits provided by, alternative trading systems").

competition among trading centers. Accordingly, rather than proposing to reduce the threshold to 0% and, thereby, effectively requiring that any orders communicated by an ATS to more than one person be made available to the market as a whole, the Commission is proposing a new threshold of 0.25%.

Regulation ATS was designed to balance the benefits of reducing barriers to entry for non-exchange trading venues with the need for appropriate regulation and coordination among exchange and non-exchange trading venues.<sup>67</sup> The proposed display threshold of 0.25% is designed to keep barriers to entry for new ATSs low so as to promote competition, while reducing the amount of important price information that is selectively displayed outside the public quote stream. A new ATS that has not yet reached the 0.25% threshold in an NMS stock would, under the proposed amendments, be permitted to communicate orders in NMS stocks – whether via actionable IOIs or otherwise – to selected market participants. Such an ATS would be able to commence operations without, at least initially, incurring linkage and other costs associated with the requirement to provide order display and execution access. Although the Commission preliminarily believes that these costs are not unduly burdensome, the Commission is sensitive to these costs and preliminarily believes that it is not appropriate at this time to impose such costs on new ATSs that display subscriber orders outside the public quote stream, whether by communicating actionable IOIs or otherwise.<sup>68</sup>

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<sup>67</sup> See Regulation ATS Adopting Release, *supra* note 36, 63 FR at 70847 ("The Commission believes the framework it is adopting meets the varying needs and structures of market participants and is flexible enough to accommodate the business objectives of, and the benefits provided by, alternative trading systems").

<sup>68</sup> If the proposed changes to Rule 301(b)(3) are adopted, a new ATS could engage in limited display of orders in any NMS stock until it reached an average daily trading volume of 0.25% or more in that NMS stock over four of the preceding six months. The Commission preliminarily believes that this proposed threshold should provide a new ATS entrant sufficient opportunity to initiate and develop its business. A new ATS also

Although the Commission preliminarily believes that most established ATSs that communicate actionable IOIs would be covered by the proposed trading volume threshold,<sup>69</sup> it also preliminarily believes that the proposed amendments to Rule 301(b)(3)(ii) of Regulation ATS would not impose significant costs or inappropriate compliance burdens on such ATSs. As discussed below,<sup>70</sup> for those ATSs that would become subject to Regulation ATS's order display and execution access requirements because of the lowering of the display threshold, and that would comply with that obligation by providing their best-priced orders to an SRO for inclusion in the public quote stream, the Commission preliminarily believes that the costs of linking to an SRO are not substantial. The communications and order-routing systems necessary to comply with Regulation ATS's order display and execution access requirements have improved significantly since they were originally adopted. The Commission believes that robust and extremely fast linkages that were not available at that time are now widely offered on commercially reasonable terms. It also appears that the market for these services is highly competitive, further reducing their cost. The Commission notes that for ATSs currently operating as ECNs, even those with relatively small market shares, already incur the costs

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could structure its business to avoid any display of orders, and thus any impact of the proposed amendments. Consequently, the Commission does not anticipate that the proposed amendments would lessen competition among or innovation by securities markets.

<sup>69</sup> Based on information provided to the Commission by dark pool ATSs on their quarterly Forms R-31, many such ATSs are above 0.25% of total national volume in all NMS stocks. If an ATS has over 0.25% of total national volume in all NMS stocks, it likely exceeds 0.25% in many individual NMS stocks – and thus would become subject to Regulation ATS's display and execution access requirements with respect to such NMS stocks, if the 0.25% threshold were to be adopted by the Commission.

<sup>70</sup> See infra in section VI.B.

associated with providing their best-priced orders to an SRO for inclusion in the public quote stream.<sup>71</sup>

Any ATS would be able to avoid any direct impact from the proposed amendments by ceasing to send actionable IOIs to more than one person. Such an ATS would not incur any costs to link to an SRO for the purpose of providing its best-priced orders to an SRO for inclusion in the public quote stream. The Commission understands that some ATSs already operate on a completely dark basis, which suggests that this may be a viable business strategy for additional ATSs.<sup>72</sup>

The proposed amendments are designed to create a more level playing field with respect to order display and execution access for all market participants that receive and attempt to execute orders, including exchanges, ATSs, and OTC market makers. By amending Rule 301(b)(3) to make the order display and execution access requirements of ATSs more closely

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<sup>71</sup> Some ECNs display or have in the past displayed their orders in FINRA's Alternative Display Facility ("ADF"). Market participants that wish to trade against an ECN order displayed on the ADF must route a contra-side order to the ECN, as the ADF itself does not provide execution functionality. Other ECNs display or have in the past displayed their orders on national securities exchanges that provide an "order delivery" functionality. When an order arrives at the exchange seeking to execute against an ECN order that is displayed on the exchange, the exchange will "deliver" the contra-side order to the ECN for execution. This order delivery functionality is designed to eliminate the possibility of a double execution of the ECN order (once against an order sent to the exchange and once against an order sent directly to the ECN). To be competitive and comply with relevant regulatory requirements, including Regulation NMS, the exchange and ECN trading systems must be closely integrated and have very high reliability and speed. The prevalence of these order display and routing arrangements employed by ECNs suggests that it would not be inappropriately burdensome for other ATSs to undertake similar order display and routing arrangements to include their trading interest in the consolidated quotation data.

<sup>72</sup> Certain ATSs generate executions by communicating actionable IOIs to selected market participants and thereby benefit from the current regulatory structure. The Commission acknowledges that the proposed amendments could impact such ATSs. However, as explained in this Release (see *infra* section VI.B), the Commission preliminarily believes that the potential benefits to the broader market of the proposed changes to Rule 301(b)(3) would justify these impacts.

parallel those of other market participants, the Commission preliminarily believes that the national market system would be fairer, more transparent, and more competitive – to the benefit of all investors.

**B. Elimination of "in the alternative trading system" limitation**

In its current form, the display requirement of Regulation ATS applies only with respect to orders that are displayed to more than one person in the alternative trading system.<sup>73</sup> As the Commission noted in the Regulation ATS Adopting Release, the term "person in the alternative trading system" means a subscriber of the ATS.<sup>74</sup> The Commission noted that this language would permit ATSs that operated a negotiation feature from incurring any order display obligations pursuant to Regulation ATS.<sup>75</sup>

The Commission proposes to amend Rule 301(b)(3)(ii) by eliminating the phrase "in the alternative trading system" and replacing it with the phrase "(other than alternative trading system employees)." The purpose of eliminating the phrase "in the alternative trading system" would be to make an ATS that meets the volume threshold subject to the display obligation whenever it displays an order in an NMS stock to more than one person, regardless of whether

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<sup>73</sup> See 17 CFR 240.301(b)(3)(ii) ("[s]uch alternative trading system shall provide to a national securities exchange or national securities association the prices and sizes of 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").

<sup>74</sup> See Regulation ATS Adopting Release, supra note 36, 63 FR at 70866 ("alternative trading systems are not required to provide to the public quote stream orders displayed to only one other alternative trading system subscriber"); id. at 70867 ("Rule 301(b)(3) only requires alternative trading systems to publicly disseminate the best priced orders that are displayed to other alternative trading subscribers").

<sup>75</sup> See id. at 70866. Using a negotiation feature, two subscribers of an ATS would communicate with each other using the facilities of the ATS in an attempt to reach agreement on the terms of a transaction. The negotiation could result in one subscriber communicating a firm order to another subscriber, which the latter could accept or reject.



those persons are subscribers of the ATS. When the Commission adopted Regulation ATS in 1998, trading technology and business strategies had not yet evolved to the point where communicating order information to anyone other than a subscriber of an ATS was feasible or even desirable. Given the state of the market in 1998, the Commission did not consider imposing, and thus did not adopt, a display obligation with respect to order information communicated to non-subscribers.

More recent technological developments require the Commission to revisit this issue. As markets have become highly automated and systems for sending, receiving, and processing large numbers of electronic messages have grown more robust and more widely available, many market participants – including some ATSs – now communicate actionable IOIs to attract potential counterparties for subscriber orders that they hold.<sup>76</sup> In many cases, the recipients of those IOIs are not subscribers of the ATS and thus are not "in" the ATS. In its current form, however, Rule 301(b)(3) does not cover this type of display, even if the ATS exceeds the current 5% threshold.

The development and implementation of new technology – particularly the ability of third-party vendors to provide fast and robust order-routing services to a wide number of venues on commercially attractive terms – support extending Regulation ATS's display requirements to instances where orders are displayed to more than one person, regardless of whether such persons are subscribers of the ATS. Whether or not a recipient of such order information is deemed to be "in" the ATS, communication of such information to a limited subgroup of market

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<sup>76</sup> The recipient of such information can respond by sending a firm order back to the sender with the goal of interacting with the contra-side order held by the sender.

participants has the potential to create a two-tiered market.<sup>77</sup> Thus, the Commission preliminarily believes that the phrase "in the alternative trading system" unduly restricts the order display and execution access obligations of ATSS, and that the proposed amendment to Rule 301(b)(3)(ii) is appropriate to further the objectives of a national market system.

While the Commission is proposing to delete the phrase "in the alternative trading system" from Rule 301(b)(3)(ii), it is proposing to replace it with the phrase "(other than alternative trading system employees)." The ability of ATS employees to see such order information should not affect whether the ATS is required to provide its best-priced orders to an SRO for inclusion in the public quote stream. Existing Rule 301(b)(3)(i)(A) already contains the language "(other than alternative trading system employees)." By inserting the same phrase in Rule 301(b)(3)(ii), the Commission would clarify that no display obligations are triggered because ATS employees can see subscribers' order information.

### **C. Size Discovery Exclusion**

The Commission proposes to revise Rule 301(b)(3)(ii) of Regulation ATS to add an exclusion for certain large orders to make it consistent with the proposed amendments to the definition of "bid" or "offer" discussed in section II above. Rule 301(b)(3)(ii) currently states that an ATS is required to provide to an SRO the prices and sizes of the orders at the highest buy price and the lowest sell price for any NMS stock for inclusion in the public quote stream that are, among other things, displayed to more than one person in the ATS. The Commission proposes to amend Rule 301(b)(e)(ii) to exclude "orders having a market value of at least

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<sup>77</sup> However, under the proposal, a negotiation system that allowed one subscriber to communicate an order to a second subscriber in an attempt to reach agreement on the terms of a transaction would continue to be exempt from any order display or execution access requirements under Regulation ATS, because the system is not displaying subscriber orders to more than one person.

\$200,000 that are displayed only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000.”

With respect to such "size discovery orders,"<sup>78</sup> this proposed amendment to Rule 301(b)(3)(ii) would make the exception from the order display and execution access requirements applicable to ATSS consistent with the proposed exception in Rule 602 applicable to exchanges and responsible brokers and dealers. If Rule 301(b)(3)(ii) were not amended in this manner, the proposed exception to display requirements for size discovery IOIs in Rule 602 would not apply to ATSS. Rule 300(e) of Regulation ATS<sup>79</sup> defines the term "order" for purposes of Regulation ATS as including "any bid or offer quotation" which, if the Commission adopts this proposal, would no longer include size discovery IOIs. However, Rule 300(e) also defines the term "order" to include any "other priced order." Because a size discovery order could be an "other priced order," a size discovery order could be subject to the order display and execution access requirements of Rule 301(b)(3)(ii), regardless of any change to the definition of "bid" or "offer" in Rule 602. Therefore, the Commission is proposing to amend Rule 301(b)(3)(ii) to explicitly provide that "orders having a market value of at least \$200,000 that are displayed only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000" would not be subject to Regulation ATS's order display and

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<sup>78</sup> The Commission notes that the proposed exclusion from Rule 301(b)(3)(ii) would apply to "orders" meeting certain criteria rather than to "indications of interest," which are the subject of the proposed exception to Rule 600(b)(8) of Regulation NMS discussed above. Because the term "order" is defined broadly in Regulation ATS and incorporated into multiple aspects of the regulation (i.e., recordkeeping and reporting requirements), the Commission preliminarily believes that an effort to distinguish and exclude size discovery IOIs from the definition of "order" under Regulation ATS would have additional and unintended effects on Regulation ATS.

<sup>79</sup> 17 CFR 242.300(e).

execution access requirements.<sup>80</sup> For the same reasons discussed in section II above,<sup>81</sup> the Commission preliminarily believes that the proposed amendment to Rule 301(b)(3)(ii) would appropriately balance preventing two-tiered markets and encouraging the public display of limit orders with affording certain large orders some opportunity for size discovery without having to be displayed in the public quote stream.

#### **D. Request for Comment**

The Commission requests the views of commenters on all aspects of the proposed amendments to Regulation ATS described above. The Commission also requests particular comment on the following:

1. Is 0.25% of aggregate average daily share volume in an NMS stock an appropriate threshold to trigger the order display and execution access requirements of Regulation ATS? Why or why not? Should the Commission adopt a higher or lower threshold? If so, what should that threshold be and why? Should the Commission leave the threshold at 5%? Would a threshold of 0.25% achieve the desired balance of not creating a barrier to entry for new ATSs while capturing most established ATSs that communication actionable IOIs? Are there other considerations and goals the Commission should take into account in establishing a new threshold?

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<sup>80</sup> Because the Commission's objective in the present proposal relates only to order display and execution access required by Rule 301(b)(3)(ii), no change to the definition in Rule 300(e) is being proposed. Therefore, other requirements relating to orders in Regulation ATS – including fair access; capacity, integrity, and security; recordkeeping; reporting; and the confidential treatment of trading information (see 17 CFR 242.301(b)(5), (b)(6), (b)(8), (b)(9), and (b)(10), respectively – would continue to apply with respect to all orders, whatever their size. In addition, executions of all orders, whatever their size, would continue to count toward an ATS's trading volume threshold for purposes of Rule 301(b)(3).

<sup>81</sup> See supra section II.

2. Should the Commission adopt a threshold based on additional or different criteria other than trading volume (e.g., adjusting the trading volume threshold based on the liquidity of an NMS stock)? If the Commission were to do so, how should that threshold be determined and calculated? For example, what would be the appropriate time period for a liquidity-based threshold?

3. Is it consistent with the Commission's goals to permit very low volume ATSs to display orders to more than one person outside the public quote stream (by communicating actionable IOIs or otherwise) as would be the case with a display threshold of 0.25%, or should the display threshold be 0%? Are such IOIs typically used for more or less liquid NMS stocks? Should the types of NMS stocks that are typically associated with IOI usage affect the setting of the display threshold? If so, how?

4. Would lowering the average daily trading volume threshold to 0.25% promote price transparency and price discovery in the national market system? Why or why not? Are there other rule amendments the Commission could adopt that would achieve the Commission's goals?

5. Should the order display requirements of Rule 301(b)(3) include a size discovery exclusion for large orders? Is a principal amount of \$200,000 an appropriate value to define large orders for this purpose? Should the Commission adopt a higher or lower threshold? If so, what should that threshold be and why? Are there other or additional criteria, such as number of shares, on which the exclusion should be based? If so, what are those criteria?

6. Is the amendment to Rule 301(b)(3)(ii) eliminating the phrase "in the alternative trading system" appropriate? Should the application of the order display requirements of Rule 301(b)(3)(ii) remain limited to orders that are displayed only to subscribers of an ATS? If so, why?

7. What would be the most likely method of compliance by ATSS were the Commission to adopt the proposed amendments to Rule 301(b)(3)? Do you believe that ATSS that currently send actionable IOIs would choose to comply with the proposed amendments to Regulation ATS by submitting subscriber orders to an SRO for inclusion in the public quote stream or by going completely dark (i.e., not disclosing any information about subscriber orders, whether via IOIs or otherwise)? What percentage of ATSS (whether by number or by the percentage of ATS trading volume that they represent) do you estimate would choose each option? Are there other options not discussed here that ATSS might pursue? Are there other policy implications that the Commission should consider regarding the likely responses by ATSS if the Commission were to adopt the proposed amendments?

8. Do you believe that subscribers of ATSS would change how they use ATSS if the Commission were to adopt the proposed amendments to Regulation ATS? If so, how?

9. How would the proposed amendments affect ATS revenues and the ability of ATSS to offer new products and services?

10. How would the proposed amendments affect internalization and payment-for-order-flow arrangements? Would the proposed amendments provide greater incentives to initiate internalization programs in lieu of developing a new ATS?

11. Would the proposed amendments increase or decrease trading costs for institutional investors? If so, please describe and quantify.

12. What would be the effects, if any, on the price discovery process for NMS stocks, their overall liquidity, or other trading characteristics if more ATSS went completely dark?

13. What costs would an ATS incur as a result of the proposed amendments to Rule 301(b)(3)? If an ATS that communicates actionable IOIs chose to comply with amended Rule

301(b)(3) by providing orders to an SRO for inclusion in the public quote stream, what would be the costs of the attendant linkage and order-routing systems (on both an initial and ongoing basis) and their related costs (e.g., compliance costs)? Do you agree with the Commission's preliminary assessment that fast and robust linkage and order-routing systems are widely available to market participants on commercially reasonable terms?

14. Would the proposed amendments to Rule 301(b)(3) have any impact (positive or negative) beyond those described in this release? Would the proposed amendments raise any additional issues that the Commission should consider?

#### **IV. Post-Trade Transparency for ATSS**

##### **A. Background**

##### **1. Joint-SRO Arrangements for Disseminating Market Information**

Section 11A(a)(2) of the Exchange Act, adopted by the Securities Acts Amendments of 1975 (“1975 Amendments”),<sup>82</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. Among those findings and objectives is “the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities.”<sup>83</sup>

Using this authority, the Commission has required the SROs to act jointly pursuant to various national market system plans in disseminating consolidated market information.<sup>84</sup> Under

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<sup>82</sup> Pub. L. 94-29, 89 Stat. 97 (1975).

<sup>83</sup> Section 11A(a)(1)(C)(iii) of the Exchange Act, 15 U.S.C. 78k-1(a)(1)(C)(iii).

<sup>84</sup> See, e.g., 17 CFR 242.601. This rule requires exchanges to file a transaction reporting plan concerning transactions in listed equity securities executed through their facilities

this regulatory framework, the SROs have developed and funded, and presently operate, the systems that disseminate a highly-reliable, real-time stream of consolidated market information throughout the United States and the world.

The joint-industry plans that provide for the dissemination of last sale information for equity securities are the Consolidated Tape Association Plan (“CTA Plan”) and the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation, and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis (“Nasdaq UTP Plan”) (collectively “the Plans”).<sup>85</sup> These plans govern the arrangements for disseminating consolidated trade information. Among other things, the plans require the individual SROs to provide trade information for an NMS stock to a securities information processor (“SIP”), which then consolidates the information into a single stream for dissemination to the public. In this way, the public has access to a highly reliable source of information that is consolidated from all the market centers that trade a particular security.<sup>86</sup>

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and imposes a parallel requirement on associations for transactions effected otherwise than on a national securities exchange.

<sup>85</sup> The CTA Plan is available at <http://www.nyxdata.com/cta> and the Nasdaq UTP Plan is available at <http://www.utpdata.com>. These plans are transaction reporting plans as well as National Market System Plans and were submitted by the plan participants for notice, comment, and approval by the Commission. The CTA Plan was originally declared effective pursuant to Section 17(a) of the Act and Rule 17a-15 thereunder. See Securities Exchange Act Release No. 10787 (May 10, 1974), 39 FR 17799 (May 20, 1974). It was subsequently approved, as amended, under Section 11A of the Act. See Securities Exchange Act Release No. 16589 (February 19, 1980), 45 FR 12377 (February 26, 1980). The Nasdaq UTP Plan was approved pursuant to Section 11A(a)(3)(B). See Securities Exchange Act Release No. 28146 (June 26, 1990), 55 FR 27917 (July 6, 1990).

<sup>86</sup> For a more detailed description of the Plans, see Market Information Concept Release, supra note 3, 64 FR at 70616.



The CTA Plan provides for the dissemination of trade information for any CTA “Eligible Security” which is defined as any common stock, long-term warrant, preferred stock, or right admitted to dealings on the New York Stock Exchange LLC (“NYSE”), NYSE Amex LLC (“NYSE Amex”) or the “regional exchanges.”<sup>87</sup> The CTA Plan is administered by the Consolidated Tape Association (“CTA”), which consists of a representative from each of the twelve U.S. equities markets.<sup>88</sup>

The Nasdaq UTP Plan was approved on a pilot basis in 1990;<sup>89</sup> it became operational in 1994.<sup>90</sup> The Nasdaq UTP Plan governs the collection, processing, and dissemination on a consolidated basis of quotation information and transaction reports in Eligible Securities for each of its Participants.<sup>91</sup> Eligible Securities under the Nasdaq UTP Plan means any Nasdaq Global Market or Nasdaq Capital Market security (“Nasdaq securities”) as defined in Nasdaq Rule 4200, but does not include any security that is defined as an “Eligible Security” within Section VII of

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<sup>87</sup> Nasdaq securities are expressly excluded from this definition. See CTA Plan, Sections I(p) and (q), and VII. The Consolidated Quotation Plan provides for the consolidation of quotations from the markets trading the securities covered by the CTA Plan.

<sup>88</sup> The participants are: BATS Exchange, Inc.; Chicago Board Options Exchange, Inc.; Chicago Stock Exchange, Inc.; Financial Industry Regulatory Authority, Inc.; International Securities Exchange, LLC; The NASDAQ Stock Market LLC; NASDAQ OMX BX, Inc.; NASDAQ OMX PHLX, Inc.; National Stock Exchange, Inc.; New York Stock Exchange LLC; NYSE Amex LLC; and NYSE Arca, Inc. (collectively, the “Participants”).

<sup>89</sup> See supra note 85.

<sup>90</sup> See Securities Exchange Act Release No. 34371 (July 13, 1994), 59 FR 37103 (July 20, 1994). Before 1994, the Commission had to grant unlisted trading privileges (“UTP”) to an exchange in order for the exchange to trade an over-the-counter (“OTC”) security. Before the Nasdaq UTP Plan was approved, the Commission approved a limited pilot for exchanges to trade OTC securities. See Securities Exchange Act Release No. 22412 (September 16, 1985), 50 FR 38640 (September 24, 1985). In 1994, the Exchange Act was amended to permit exchanges to trade OTC securities on a UTP basis without Commission action.

<sup>91</sup> See Nasdaq UTP Plan, Section II.

the CTA Plan.<sup>92</sup> This consolidated information provides investors with the current quotation and last sale information in Nasdaq securities. It enables investors to ascertain from one data source the current prices in all the markets trading Nasdaq securities. The Nasdaq UTP Plan serves as the transaction reporting plan for its Participants and is a prerequisite for their trading of Nasdaq securities.<sup>93</sup> The Nasdaq UTP Plan is administered by the participating exchanges and association, and applies to all of the markets that trade equity securities.<sup>94</sup> Amendments submitted by SROs to the Plans are subject to Commission review under Rule 608 of Regulation NMS.<sup>95</sup> Further, the Commission may itself amend National Market System plans, pursuant to Rule 608(b)(2) of Regulation NMS.

## **2. Alternative Trading Systems and Their Arrangements for Disseminating Market Information**

Rules applicable to ATSS are set forth in Regulation ATS.<sup>96</sup> ATSS can choose whether to register as national securities exchanges or to register as broker-dealers and comply with additional requirements under Regulation ATS, depending on their activities and trading volume.<sup>97</sup> ATSS that register as broker-dealers<sup>98</sup> are required to be SRO members.<sup>99</sup> Because ATSS effect transactions in the OTC market, they must be members of FINRA.<sup>100</sup>

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<sup>92</sup> See Nasdaq UTP Plan, Section III (B).

<sup>93</sup> See 17 CFR 242.608; See also Securities Exchange Act Release No. 55647 (April 19, 2007), 72 FR 20891 (April 26, 2007).

<sup>94</sup> See *supra* note 7.

<sup>95</sup> See 17 CFR 242.608.

<sup>96</sup> See 17 CFR 242.300 *et seq.*

<sup>97</sup> See 17 CFR 242.301.

<sup>98</sup> See Section 15(b) of the Act, 15 U.S.C. 78o(b).

<sup>99</sup> See Section 15(b)(8) of the Act, 15 U.S.C. 78o(b)(8).

<sup>100</sup> *Id.*

Rule 601(b) of Regulation NMS under the Exchange Act, which governs the dissemination of transaction reports and last sale information in national market system securities, requires SRO members to transmit the information required by the transaction reporting plans to the SRO.<sup>101</sup> OTC trades, including trades executed by ATSS, are reported to the consolidated trade streams through one of the trade reporting facilities (“TRFs”) operated by FINRA on behalf of exchanges,<sup>102</sup> or through FINRA’s ADF.<sup>103</sup> The published trade reports identify the trades as OTC trades; they do not identify the particular ATS or other broker-dealer that reported the trade.<sup>104</sup>

## **B. Proposed Amendments to the Plans**

The Commission has long believed 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>105</sup> The Commission has consistently supported making timely and accurate reports of transactions available to the public.<sup>106</sup> A transparent market is a market

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<sup>101</sup> See 17 CFR 242.601(b).

<sup>102</sup> See FINRA Rules 6300 et seq. FINRA has established the following TRFs (each in conjunction with the pertinent Exchange): the FINRA/NASDAQ TRF and the FINRA/NYSE TRF.

<sup>103</sup> See FINRA Rules 6200 et seq. The ADF is both a trade reporting and quotation display and collection facility for purposes of transactions in NMS stocks effected otherwise than on an exchange.

<sup>104</sup> Members reporting trades to FINRA attach their unique Market Participant Symbols (“MPIDs”) for reporting a trade to a TRF or the ADF, but the MPID is not disseminated publicly on trade reports. Trades reported to one of the two FINRA TRFs are transmitted to the SIPs for CTA or Nasdaq UTP (and disseminated to the public) with a market center identifier of FINRA and a sub-indicator for the relevant exchange TRF (i.e., NYSE or NASDAQ).

<sup>105</sup> See, e.g., Market Information Concept Release, supra note 3, at 70614.

<sup>106</sup> See, e.g., Securities Exchange Act Release No. 16589 (February 19, 1980), 45 FR 12377 (February 26, 1980) (amending the rule governing the collection and dissemination of transaction reports and last sale data).

in which investors and their brokers have information about the current buying and selling interest in a security, as well as information about the price and size of recent transactions and where those transactions have taken place.<sup>107</sup> In particular, the Commission has long been an advocate of post-trade transparency and has encouraged the markets to enhance the information made available to the public regarding transactions effected on exchanges and in the OTC market.<sup>108</sup> As the Commission has stated in the past, transparency allows all market participants to assess overall supply and demand, substantially counteracts the effects of fragmentation that necessarily characterize a decentralized market structure, without forcing all executions into one market, and can reduce the “information gap” between investors with differing degrees of sophistication.<sup>109</sup> Nationwide disclosure of market information is necessary to assure the efficient pricing of securities, to maximize the depth and liquidity of the securities markets and to provide investors with the opportunity to receive the best possible execution of their orders.<sup>110</sup>

Since the adoption of Regulation ATS, the equity markets have evolved and, among other things, trading activity has become less concentrated. The share of trading volume at certain major national securities exchanges has declined over the last several years.<sup>111</sup> ATSs, including those that are ECNs and those that are dark pools, have gained a growing share of equity trading

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<sup>107</sup> See, e.g., Securities Exchange Act Release No. 50700 (November 18, 2004), 69 FR 71256, 71271 (December 8, 2004).

<sup>108</sup> See, e.g., Securities Exchange Act Release No. 30569 (April 10, 1992), 57 FR 13396 (April 16, 1992) (stating, among other things, that real-time publicly disseminated trade reporting is crucial to the efficient and fair operation of capital markets).

<sup>109</sup> See id.

<sup>110</sup> See, e.g., SEC, STATEMENT OF THE SECURITIES AND EXCHANGE COMMISSION ON THE FUTURE STRUCTURE OF THE SECURITIES MARKETS (February 2, 1972), 37 FR 5286, 5287 (March 14, 1972).

<sup>111</sup> See supra notes 9-10 and accompanying text.

in the past several years.<sup>112</sup> Currently, approximately 38 percent of trading volume in NMS stocks is reported as OTC (which includes ATS trades).<sup>113</sup> The lack of information concerning the ATS on which trades are executed makes it difficult, if not impossible, for the public to assess ATS trading in real-time, and to reliably identify the volume of executions in particular stocks on individual ATSS.

The Commission preliminarily believes that the current level of post-trade transparency for ATSS is inadequate. Requiring ATS trades to carry a specific identifier that would be disseminated publicly would equalize the trade reporting requirements for exchanges and ATSS, both of which operate systems that bring together orders of multiple buyers and sellers on an agency basis. Accordingly, the Commission is proposing to amend the Plans to require the disclosure of the identity of individual ATSS on trade reports in the public data stream, the same way exchange trades are identified. Requiring the public disclosure of the individual ATS that executed a trade should enable market participants to better assess in real-time where executions in particular securities are occurring among various ATSS in the over-the-counter market. In addition, the proposal should allow more reliable trading volume statistics to be calculated for individual ATSS. The Commission preliminarily believes this should enhance the ability of broker-dealers and their customers to more effectively find liquidity and achieve best execution in the over-the-counter market.

However, the Commission is sensitive to the need of investors executing large size trades to control the information flow concerning their transactions, and preliminarily believes that the

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<sup>112</sup> See Securities Exchange Act Release No. 59248 (January 14, 2009), 74 FR 4357, 4361 (January 26, 2009); see also Regulation ATS Adopting Release, *supra* note 36, at 70844.

<sup>113</sup> See, e.g., market volume statistics available at [http://www.batstrading.com/market\\_summary](http://www.batstrading.com/market_summary) (OTC volume in NMS stocks was 37.7% during 5-day period ending September 21, 2009)

disclosure of the identity of the ATS that has executed a particular large size trade could potentially cause undue information leakage about that trading. Identification of an ATS that focuses on such block trading, for example, could signal to the market that the entity trading may plan to execute more trades in the same securities, with the risk that other market participants may attempt to take advantage of this information, to the detriment of the entity engaged in those large trades. The Commission preliminarily believes that the benefits of not disclosing the identity of ATSS that execute large size trades justify not providing such post-trade information about large size trades. The Commission also preliminarily believes that the exception for large size trades strikes the appropriate balance between the need of investors executing large size trades to minimize significant information leakage and the right of the investing public to have this identifying post-trade information. Therefore, the Commission is not proposing to require the identification of ATSS on trade reports in the public data stream for large size trades.<sup>114</sup>

Specifically, the Commission is proposing to revise the definition in the CTA Plan of Last Sale Price Information, to add language at the end of the first paragraph of Section VI(f) (Market Identifiers) of the CTA Plan, and to revise the second and third sentences of Section VIII(a) (Responsibility of Exchange Participants). Together, these changes would amend the CTA Plan to require that all last sale prices collected by FINRA from each ATS be accompanied by an identifier unique to the ATS and distributed by the SIP, unless the trade has a market value of at least \$200,000. Such trades would continue to be reported as OTC trades without an ATS identifier.

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<sup>114</sup> As with the other proposed amendments discussed above in the release, the Commission is proposing to use the \$200,000 figure to define large size trades. It is a figure that is well recognized as constituting a large size order. The Commission is concerned that with these large size trades there is more potential for information leakage. For a more detailed discussion of large size trades and the \$200,000 figure, see section II.

The Commission also is proposing to amend the Nasdaq UTP Plan to achieve the same result. Specifically, the Commission is proposing to revise the definition of “Transaction Reports” in Section III (U), the language in Section VI(C)(3) regarding processor dissemination of information via transaction reports, and Section VIII(B) regarding Transaction Reports. Together, these changes would amend the Nasdaq UTP Plan to require that all last sale prices collected by FINRA from each ATS be accompanied by an identifier unique to the ATS and distributed by the SIP, unless the trade has a market value of at least \$200,000. Such trades would continue to be reported as OTC trades without an ATS identifier.

Currently, as discussed above, the identity of the ATSs is not reported to the public data stream. Recognizing the changes that have taken place in the marketplace and the increased share of equity trading by ATSs in the last number of years, the Commission preliminarily believes that requiring the disclosure of the identity of ATSs on their trade reports in the public data stream should be beneficial to investors. The proposed amendments would augment available trade information, provide important information about trading volumes of ATSs, including dark pools, as well as information on which ATSs may have liquidity in particular stocks. The Commission also preliminarily believes that the resulting improved transparency would help ensure that publicly available prices fully reflect overall supply and demand, equip the investing public with tools to make better investment decisions, increase the perception of fairness that is necessary for the healthy functioning of the national market system, and, as a result, enhance public confidence in the securities markets.<sup>115</sup>

### **C. Request for Comment on Proposed Plan Amendments**

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<sup>115</sup> See supra notes 107-109 and accompanying text.

The Commission invites interested persons to submit written comments on any aspect of the proposed Plan amendments. The Commission seeks comment on whether there are alternative approaches to improving ATS post-trade transparency that the Commission should consider that would achieve the Commission's stated goals. The Commission specifically seeks comment on whether the amendment of the Plans is the best way to address the matter. If there are alternative approaches, such as requiring the TRFs to make the identity of ATSs that submit trade reports available to the public as part of their proprietary data streams, please discuss your suggested approach, its feasibility, and how it would achieve the Commission's goals. In addition, the Commission seeks comment on the timing and level of detail that ATSs should be required to provide about their trading activity. Would summary information, such as end-of-day volume statistics be preferable to real-time, trade-by-trade disclosure? If so, please explain your reasoning. Would real-time identification of ATS trades cause inappropriate information leakage concerning customer orders or result in other unintended consequences? What modifications could the Commission make to its proposal to address any such concerns? Will the proposed change affect trading on exchanges, where no large trade exception applies? The Commission also seeks comment on whether the proposed exception to the ATS trade reporting requirement for large size trades is justified and would help minimize concerns about information leakage. If a large size trade exception is not appropriate, please explain why you believe such an exception is not necessary. Further, is the proposed threshold the appropriate one, or should it be higher or lower? Should the Commission consider using a threshold other than a dollar threshold, such as a certain number of shares? How should the Commission establish such a threshold; for example, should it use other existing thresholds? If the Commission adopts the Plan amendments with the exemption for large size trades, should the



Commission require that the information with respect to which ATS effected the large size trades be made public at the end of the day (or at other time intervals), rather than in real-time as would occur if this were included in the consolidated data stream? In addition, comment is requested on the effect of the proposed post-trade disclosure on investors, ATSs, vendors and others that may be affected by the proposed amendments, as well as the effect on the market place and any competitive effect the proposed Plan changes may have.

## **V. Paperwork Reduction Act**

### **A. Actionable IOIs**

The proposed amendment of Rule 600(b)(8) of Regulation NMS does not contain any “collection of information requirements” within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).<sup>116</sup> Rule 600 of Regulation NMS contains all of the defined terms used in Regulation NMS. The proposed amendment of Rule 600(b)(8) would revise the definition of “bid” or “offer” by expressly limiting its exclusion of IOIs to those “that are not actionable and indications of interest for a quantity of NMS stock having a market value of at least \$200,000 that are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000.” The practical result of the amendment would be that actionable IOIs that do not qualify for the size discovery exclusion would be “bids” or “offers.”

While the amendment to Rule 600(b)(8) does not contain any collection of information requirements within the meaning of the PRA, the proposed change in the definition of “bid” or “offer” could affect the collection of information burdens under Rule 602 of Regulation NMS.<sup>117</sup>

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<sup>116</sup> 44 U.S.C. 3501, et seq.

<sup>117</sup> The proposed amendment to Rule 600(b)(8) of Regulation NMS also may affect the obligations imposed by Rule 301(b)(3) of Regulation ATS on ATSs that meet the specified trading volume threshold. Rule 301(b)(3) does not, however, currently contain a collection of information requirement as defined by the PRA because it currently

“Bid” and “offer” are key terms that determine the scope of Rule 602 of Regulation NMS. In general, Rule 602 requires exchange members and OTC market makers to provide their best-priced bids and offers to their respective exchanges and FINRA. The exchanges and FINRA, in turn, are required to make their best bids and offers available in the consolidated quotation data. The Commission does not believe that the proposed amendment to Rule 600(b)(8) would require any new or additional collection of information under Rule 602. Exchange members and certain OTC market makers would continue to be required to provide their best-priced bids and offers to their respective exchanges and FINRA.<sup>118</sup> The proposed amendment to Rule 600(b)(8) could increase the number of “bids” or “offers” that exchange members and OTC market makers would be required to review to determine their best-priced bids and offers. It is the Commission’s understanding that all exchange members and OTC market makers have systems and procedures in place to make this determination today. As a result, the Commission believes that any burden increase in determining their best-priced bids and offers due to the proposed inclusion of actionable IOIs in the definition of “bid” or “offer” would not substantively or materially change existing collection burdens.<sup>119</sup> The Commission encourages comment on all aspects of this issue. In addition, the Commission encourages specific comment on:

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affects fewer than ten entities. However, the proposal to lower the trading volume threshold contained in Rule 301(b)(3)(i)(B) could affect the number of entities subject to Rule 301(b)(3) so that the amended rule would contain a collection of information. The PRA burden associated with the proposed amendment to, and amendments affecting the application of, Rule 301(b)(3)(i)(B) are discussed below in section V.B.

<sup>118</sup> Under the definition of “subject security” in Rule 600(b)(73)(ii)(A) of Regulation NMS, an OTC market maker is not required to provide its best bids and offers for an NMS stock if the executed volume of the firm during the most recent calendar quarter comprised one percent or less of the aggregate trading volume for such NMS stock.

<sup>119</sup> The information collection contained in Rule 602, entitled “Dissemination of Quotations – Rule 11Ac1-1,” the precursor to Rule 602, has been assigned control number 3235-0461. The Commission, however, will be updating the overall burden estimate for this

1. To what extent, if at all, would the proposed amendment to Rule 600(b)(8) increase the number of bids or offers that exchange members and OTC market makers would be required to review and report to their respective exchanges and FINRA for inclusion in the consolidated quotation data? Please provide data and specific quantifications.

2. To what extent, if at all, would system changes or increases in system capacities be necessary to exchange members or OTC market makers to comply with the requirements of Rule 602, if the Commission were to adopt the proposed amendments to Rule 600(b)(8)?

## **B. ATS Display Obligations**

Certain provisions of the proposed amendments to Regulation ATS rules contain "collection of information requirements" within the meaning of the PRA.<sup>120</sup> The Commission has submitted the information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. 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 title of this collection is "Rule 301, Form ATS and Form ATS-R" (OMB Control Number 3235-0509).

### **1. Summary of Collection of Information**

Rule 301(b)(3) of Regulation ATS governs order display and execution access for ATSs. Currently, the rule provides that an ATS incurs order display and execution access obligations if it displays subscriber orders in an NMS stock to more than one person in the ATS and the ATS has 5% or more of the average daily trading volume in such NMS stock, as reported by an effective transaction reporting plan. An ATS meeting these criteria must provide to an SRO the

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collection of information to account for an increase in the number of self-regulatory organizations subject to the Rule.

<sup>120</sup> 44 U.S.C. 3501 et seq.

prices and sizes of the orders at the highest buy price and the lowest sell price for such NMS stock for inclusion in the public quote stream.

The proposed amendment to Rule 301(b)(3)(i)(B) of Regulation ATS would broaden the applicability of these order display and execution access requirements by reducing the trading volume threshold from 5% of the aggregate average daily share volume to 0.25%. The proposed amendment to Rule 301(b)(3)(ii) would clarify that the order display and execution access requirements apply when a subscriber order is displayed to more than one person (other than ATS employees), regardless of whether such persons are subscribers of the ATS. The proposed amendments to Rule 301(b)(3)(i)(A) and (ii) would provide an exception to the order display and execution access requirements for orders that have a market value of at least \$200,000 and are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000.

The proposed amendments would not impact Form ATS or Form ATS-R. ATSs would continue to evaluate and submit the same information on these forms. Accordingly, the proposed amendments, if adopted, would not result in any revision to those collections of information. However, the proposed amendments could result in more ATSs being required to establish connections to SROs in order to display their best-priced orders. Each such ATS also could be required to expand or modify its systems capacity, internal controls, and compliance policies and procedures to provide orders to an SRO in a manner consistent with the SRO's rules and enable market participants to access such orders for execution. These requirements would constitute a "collection of information" that would be subject to the PRA.

The current collection of information, "Rule 301, Form ATS and Form ATS-R" (OMB Control Number 3235-0509), does not contain a collection of information with respect to Rule

301(b)(3) of Regulation ATS. When adopted, Rule 301(b)(3) did not contain a collection of information because fewer than ten entities were affected by Rule 301(b)(3).<sup>121</sup> In addition, under the current 5% volume threshold, it remains the case that fewer than ten ATSs are required to send best-priced orders to an SRO for inclusion in the consolidated public quote system.<sup>122</sup>

Since the adoption of Regulation ATS, the number of ATSs has grown significantly, and the national market system and the nature of order interaction have evolved considerably. Currently, there are numerous dark pool ATSs, many of which use actionable IOIs as a means to attract order flow. The proposed amendment to Rule 600(b)(8) of Regulation NMS to include actionable IOIs within the definition of "bid" or "offer" and the proposed lowering of the trading volume threshold in Rule 301(b)(3) from 5% to 0.25% might impose collection of information requirements on ten or more ATSs. For this reason, the Commission has prepared an estimate of the associated compliance burdens on ATSs for purposes of the PRA, as further detailed below.

The Commission preliminarily believes that the proposed amendment to Rule 301(b)(3) of Regulation ATS would not, if adopted, substantively or materially change collection burdens for SROs under the requirements of Rule 602 of Regulation NMS.<sup>123</sup> Under the proposal, order information that is communicated by ATSs to more than one person outside the public quote stream (whether via actionable IOIs or otherwise) could be required to be incorporated into the public quote stream. As described above, to do so an ATS would send the order information to an SRO, and that SRO would then be responsible under Rule 602 for incorporating the

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<sup>121</sup> See supra note 117.

<sup>122</sup> This information is based on discussions of Commission staff with certain potential ATS respondents and other market participants.

<sup>123</sup> See supra notes 117 and 118 and accompanying text.

information into the consolidated public quote stream.<sup>124</sup> The Commission preliminarily believes, however, that the additional burden on the SRO of including such ATS orders with the large volume of quotations that the SRO already includes in the public quote stream under Rule 602 would not be substantive or material. The Commission encourages comment on this point.

## **2. Proposed Use of Information**

Rule 301(b)(3) of Regulation ATS requires an ATS to provide to an SRO the prices and sizes of the orders at the highest buy price and the lowest sell price in an NMS stock upon the satisfaction of certain threshold conditions under Rules 301(b)(3)(i)(A) and (B). If the Commission adopts the proposed amendments to Rule 301(b)(3), more than ten entities could become subject to the requirement to provide this order information to an SRO. Such information would be used by the SRO to determine the SRO's best bid, best offer, and aggregate quotation sizes. The SRO must make that information public, pursuant to Rule 602 of Regulation NMS.<sup>125</sup> This information is used, among other ways, by market participants to understand the market and to inform their trading decisions. The Commission also may use this information as part of its general market oversight and regulatory functions.

## **3. Respondents**

There are approximately 73 ATSS that are subject to Regulation ATS. Of these, approximately 11 are dark pool ATSS that use actionable IOIs. Approximately one other ATS that is not an ECN displays subscriber orders in NMS stocks on a limited basis in some other fashion.<sup>126</sup> Therefore, the Commission preliminarily believes that up to 12 ATS respondents

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<sup>124</sup> See *id.*

<sup>125</sup> 17 CFR 242.602.

<sup>126</sup> The Commission notes that there are presently four ATSS operating as ECNs, as defined in Rule 600(b)(23) of Regulation NMS, 17 CFR 242.600(b)(23). These ATSS already display customer orders in the public quote stream and permit market participants to

could be impacted by the proposed amendments to Rule 301(b)(3).<sup>127</sup> The remaining 61 ATSS likely would not be impacted for PRA purposes by the proposed amendments, because they: (a) do not display subscriber orders in NMS stocks to more than one person (whether by communicating actionable IOIs or otherwise), (b) are ECNs and already publicly display subscriber orders, or (c) do not effect transactions in NMS stocks.<sup>128</sup> The Commission seeks comment on the number of ATSS that could be impacted by the proposed changes and the nature of such impacts.

#### **4. Total Initial and Annual Reporting and Recordkeeping Burdens**

The proposed amendments to Rule 301(b)(3) of Regulation ATS would, if adopted, increase the collection of information burdens only with respect to those ATSS with sufficient volume in an NMS stock (0.25% or more of the aggregate average daily share volume) that choose to communicate actionable IOIs or that otherwise display order information to more than one person. An ATS crossing the 0.25% threshold would be required to provide its best-priced orders to an SRO for inclusion in the public quote stream. As stated previously, ATSS that are completely dark (*i.e.*, that do not display any subscriber order information, whether by communicating actionable IOIs or otherwise) would not be impacted by the proposed amendments to Rule 301(b)(3).

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access such orders. Accordingly, these systems would not have new burdens under Rule 301(b)(3), as the Commission is proposing to amend it.

<sup>127</sup> The Commission notes that, of these 12 potential respondents, any could choose to avoid Regulation ATS's order display and execution access requirements by choosing not to display subscriber orders to more than one person (or by displaying to more than one person only size discovery orders). Nevertheless, as set forth above, the Commission preliminarily believes that the proposed changes to Rule 301(b)(3) constitute a "collection of information" under the PRA. The proposed amendments also could impact new ATSS or existing ATSS that expand their business activities.

<sup>128</sup> The Commission obtains information on the securities that are traded by ATSS from the Forms ATS filed with the Commission by ATSS.

The Commission preliminarily believes that including actionable IOIs as bids or offers under Rule 600(b)(8) of Regulation NMS and reducing the average daily trading volume threshold in Rule 301(b)(3) of Regulation ATS from 5% to 0.25% could increase the order display and execution access obligations of ATSs that transmit actionable IOIs or otherwise display order information to selected market participants. These obligations could entail the initial burdens of re-programming their current systems to monitor the ATS's percentage of trading in NMS stocks, establishing linkages to an SRO for the purpose of submitting orders to the SRO for public display and of providing access to market participants wishing to trade against such orders, and expanding systems capacity and internal controls, including establishing or modifying applicable compliance policies and procedures, to carry out these functions in a manner consistent with the SRO's rules.<sup>129</sup> The Commission preliminarily believes that such obligations could include ATS staff time to build new systems or re-program current systems, as well as ongoing ATS staff time to maintain such systems and carry out their associated functions.

The Commission preliminarily estimates that the one-time, initial annualized expense for potential ATS respondents to establish connectivity to an SRO would be approximately

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<sup>129</sup> Currently, under Rule 301(b)(3) of Regulation ATS, an ATS that displays subscriber orders to any person (other than ATS employees) and has an average daily trading volume of 5% or more of the aggregate daily share volume for an NMS stock is required to provide to an SRO the best priced orders for such NMS stock for inclusion in the public quote stream. Thus, ATSs are already required to monitor trading levels in NMS stocks and have policies and procedures in place to do so. As a result of the proposed amendments to Rule 301(b)(3), which would lower the average daily trading volume threshold from 5% to 0.25% and provide for an exception to the display obligation for orders that have a market value of at least \$200,000 and are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000, ATSs could be required to re-program their respective systems that monitor trading levels in NMS stocks to reflect this change in the average daily trading volume threshold.



\$3,900,000.<sup>130</sup> In addition, the Commission preliminarily estimates that the one-time, initial annualized burdens for all potential ATS respondents to comply with the proposed amendments to Rule 301(b)(3) would be approximately 17,880 burden hours.<sup>131</sup> This figure is based on the estimated number of hours for initial internal development and implementation by an ATS to re-program its system, expand system capacity, and adjust internal controls, including costs to establish or modify applicable compliance policies and procedures.

The Commission also has estimated the ongoing expenses of complying with the proposed amendments to Rule 301(b)(3), which could include, among other things, maintaining connectivity with an SRO, monitoring daily trade activity, and ensuring compliance. The Commission preliminarily estimates that the ongoing annualized expense for all potential ATS respondents to maintain connectivity to an SRO would be approximately \$3,600,000.<sup>132</sup> In

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<sup>130</sup> This figure is the total initial, one-time annualized expense to establish electronic connections with an SRO for all potential ATS respondents and is based on discussions of Commission staff with certain potential ATS respondents and other market participants. The Commission derived the total estimated expense from the following: ((\$25,000 relating to hardware- and software-related expenses) + (\$25,000 monthly ongoing costs to maintain the connection x 12 months)) x (12 potential ATS respondents) = \$3,900,000.

<sup>131</sup> This figure is based on discussions of Commission staff with certain potential ATS respondents and other market participants. The Commission derived the total estimated one-time burdens from the following: [(Sr. Programmer at 320 hours) + (Compliance Manager at 20 hours) + (Compliance Attorney at 20 hours) + (Programmer Analyst at 20 hours) + (Sr. Systems Analyst at 30 hours)) x (2 months) + ((Sr. Programmer at 2 hours) + (Compliance Manager at 6 hours) + (Compliance Attorney at 4 hours) + (Compliance Clerk at 40 hours) + (Sr. Systems Analyst at 2 hours) + (Director of Compliance at 5 hours) + (Sr. Computer Operator at 8 hours)) x (10 months)] x (12 potential ATS respondents) = 17,880 burden hours.

<sup>132</sup> This figure is the total ongoing annualized expense to maintain electronic connections with an SRO for all potential ATS respondents and is based on discussions of Commission staff with certain potential ATS respondents and other market participants. The Commission derived the total estimated expense from the following: ((\$25,000 monthly ongoing costs to maintain the connection x 12 months)) x (12 potential ATS respondents) = \$3,600,000.

addition, the Commission preliminarily estimates that the ongoing annualized burdens for all potential ATS respondents to comply with the proposed amendments to Rule 301(b)(3) would be approximately 9,648 burden hours.<sup>133</sup> This figure includes the estimated number of internal professional staff hours for running compliance policies and procedures (including monitoring daily trading activity), ongoing system maintenance and development, and personnel costs associated with maintaining connectivity to an SRO.

The Commission is also proposing a change to Rule 301(b)(3)(ii) that would add an exception to the display and execution access requirements for orders that have a market value of at least \$200,000 and are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000. The Commission preliminarily believes that no ATS would incur any increased burdens because of the proposed exception. An ATS would incur either the same burdens (because it communicated no orders that met the terms of the proposed exception) or fewer burdens (because some or all of the orders that it communicated met the terms of the proposed exception, thus reducing the number of orders under the proposed amendments to Rule 301(b)(3) that the ATS would otherwise have to provide to an SRO for inclusion in the public quote stream). Some ATSs that might avail themselves of the proposed exception already have in place the functionality to communicate size discovery orders, have average execution sizes above \$200,000, and have developed strategies to identify market participants that are reasonably believed to represent current contra-side trading interest

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<sup>133</sup> This figure is based on discussions of Commission staff with certain potential ATS respondents and other market participants. The Commission derived the total estimated ongoing burdens from the following: ((Sr. Programmer at 2 hours) + (Compliance Manager at 6 hours) + (Compliance Attorney at 4 hours) + (Compliance Clerk at 40 hours) + (Sr. Systems Analyst at 2 hours) + (Director of Compliance at 5 hours) + (Sr. Computer Operator at 8 hours)) x (12 months) x (12 potential ATS respondents) = 9,648 burden hours.

of at least \$200,000.<sup>134</sup> Thus, the Commission preliminarily believes that such ATSs would not incur any costs if the Commission were to adopt the proposed exception.

The Commission seeks comment on the reporting and recordkeeping collection of information burdens associated with the proposed amendments. In particular:

1. How many ATSs would incur collection of information burdens if the proposed amendments to Regulation ATS were adopted by the Commission?

2. Would ATSs respond to the proposed amendments by linking to an SRO for the purpose of displaying their best-price orders in the public quote stream or by going completely dark? If the former, what would the initial and ongoing PRA burdens be of linking to an SRO to provide such orders and to offer execution access to those orders consistent with the SRO's rules?

3. What are the burdens, both initial and annual, that an ATS would incur for programming, establishing connectivity to an SRO, expanding systems capacity, and establishing compliance programs if the Commission were to adopt the proposed amendments? Would there be additional burdens associated with the collection of information under these proposed amendments?

4. What additional burdens, both initial and annual, if any, would an ATS incur related to the proposed exception for size discovery orders?

## **5. Retention Period of Recordkeeping Requirements**

An ATS would be required to retain records and information pertaining to its operations, including information that would have to be disclosed under the proposed amendments to Rule

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<sup>134</sup> The Commission obtains information about ATSs' trading methods from the Forms ATS submitted to it by ATSs.

301(b)(3), pursuant to, and for the periods specified in, Regulation ATS.<sup>135</sup> In addition, the broker-dealer operating an ATS is subject to the recordkeeping requirements specified in Section 17 of the Exchange Act and the rules and regulations thereunder.<sup>136</sup>

#### **6. Collection of Information is Mandatory**

Any collection of information pursuant to the proposed amendments to Rule 301(b)(3) would be a mandatory collection of information.

#### **7. Responses to Collection of Information Will Not Be Kept Confidential**

The collection of information resulting from the proposed amendments to Rule 301(b)(3) would not be confidential and would be publicly available.

#### **8. Request for Comment**

Pursuant to 44 U.S.C. 3505(c)(2)(B), the Commission solicits comment to:

1. Evaluate whether the proposed collection of information is necessary for the performance of the functions of the agency, including whether the information shall have practical utility;
2. Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;
3. Enhance the quality, utility, and clarity of the information to be collected; and
4. 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.

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<sup>135</sup> See, e.g., 17 CFR 242.302; 17 CFR 242.303.

<sup>136</sup> See 15 U.S.C. 78q; 17 CFR 240.17a-1 et seq.

### **C. Post-Trade Transparency for ATSS**

Certain provisions of the proposed amendments to the CTA Plan and the Nasdaq UTP Plan would result in a new "collection of information requirement" within the meaning of the PRA.<sup>137</sup> The Commission is therefore submitting this proposal to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The title for the collection of information requirements is the "CTA Plan and the Nasdaq UTP Plan, 'Post-trade Transparency for ATSS.'" Compliance with the collection of information requirements 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 control number. OMB has not yet assigned a control number to the new collection requirements in the proposed amendments to the CTA Plan and Nasdaq UTP Plan.

#### **1. Summary**

The CTA Plan and the Nasdaq UTP Plan are the joint-industry plans that provide for the dissemination of last sale information for equity securities and set forth the arrangements for dissemination of consolidated trade information. Currently, trades executed in the OTC market, including trades executed by ATSSs, are reported to the consolidated trade streams through one of the TRFs operated by FINRA on behalf of the exchanges or to the ADF. As ATSSs effect transactions in the OTC market, they must be FINRA members and the trade reports currently identify their trades as OTC trades. The ATSS that executed the trade, however, is not currently identified in the public data streams.

The proposed amendments to the CTA Plan and the Nasdaq UTP Plan would require the disclosure of the identity of those ATSSs subject to Regulation ATS on trade reports in the public

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<sup>137</sup> 44 U.S.C. 3501 et seq.

data stream. Specifically, the proposed amendments to the CTA Plan and the Nasdaq UTP Plan would require that all last sale prices collected by FINRA from each ATS subject to Regulation ATS be accompanied by an identifier unique to the ATS and be transmitted to the SIP, unless the trade is a large size trade with a market value of at least \$200,000.

The proposed Plan amendments by redefining terms in the Plans, indirectly would require ATSs to include a unique identifier when transmitting last sale price data to FINRA. All ATSs currently report their transactions to FINRA, under FINRA rules, using an MPID, but the Commission understands some ATSs currently use the MPID of their sponsoring broker-dealer. As a result, some ATSs may need to obtain a unique MPID from FINRA, which FINRA provides at no cost.<sup>138</sup> Those ATSs would need to re-program their systems to substitute the new MPID for their sponsoring broker-dealer's MPID when transmitting last sale price data to FINRA. The Commission believes that the proposed amendments to the CTA Plan and the Nasdaq UTP Plan with respect to the ATSs would result in a "collection of information," but would not trigger a burden outside the ordinary and customary business of the ATS for purposes of the PRA.

The proposed Plan amendments would require FINRA to transmit to the SIPs a unique identifier from each ATS subject to Regulation ATS, unless the trade is a large size trade (a trade with a market value of at least \$200,000). Currently, FINRA receives the MPID information from the ATSs as required by FINRA rules. FINRA, however, currently removes the MPID from the trade reports before submitting them to the SIPs. Under the proposed Plan amendments, FINRA would need to re-program its systems to transmit the MPIDs for ATS trades to the SIPs, except for large size trades with market value of at least \$200,000. The

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<sup>138</sup> ATSs can obtain an additional MPID from FINRA. See FINRA Rules 6160 and 6170.

Commission believes that the proposed amendments to the CTA Plan and the Nasdaq UTP Plan with respect to FINRA would result in a “collection of information,” as well as a minor burden for purposes of the PRA.

The proposed Plan amendments would require the SIPs, for the CTA Plan and the Nasdaq UTP Plan, to disseminate information provided to them by FINRA. Under the proposed Plan amendments, the SIPs would need to re-program their systems to enable them to accept as well as transmit trade reports with the additional data element, the MPID, for those ATS transactions that have a market value of less than \$200,000. The Commission believes that the proposed amendments to the CTA Plan and the Nasdaq UTP Plan with respect to the SIPs would result in a minor burden for purposes of the PRA.

The Commission encourages comment on all of these points.

## **2. Proposed Use of Information**

The proposed amendments to the CTA Plan and the Nasdaq UTP Plan would require that all last sale prices collected by FINRA from each ATS subject to Regulation ATS be accompanied by an identifier unique to the ATS and be transmitted to the SIP, unless the trade is a large size trade with a market value of at least \$200,000. If the Commission adopts the proposed amendments to the Plans, some ATSs would now be required to get a unique identifier, rather than use the identifier of their sponsoring broker-dealer. Such information should enable the public to determine more accurately the volume of executions occurring on any particular ATS, as well as on ATSs in general. The SIPs must make this information public, pursuant to the CTA Plan and Nasdaq UTP Plan. This information is used, among other ways, by market participants to understand the market and to inform their trading decisions. The Commission also may use this information as part of its general market oversight and regulatory functions.

### **3. Respondents**

There are approximately 73 ATSS that are subject to Regulation ATS. Of these, approximately 30 are dark pool ATSS. The Commission understands that some of these ATSS disseminate market data using the identifier of their sponsoring broker-dealer while others already use a unique identifier for their trades. Those using their sponsoring broker-dealer's identifier would have to acquire another identifier and incur a one-time systems cost to change the identifier that gets affixed to their trade reports. The ATSS using a unique identifier would not be affected for PRA purposes by the proposed Plan amendments, because they currently use a unique identifier. All last sale prices for OTC transactions are collected by FINRA and then transmitted to the SIP. The Commission seeks comment on the number of ATSS that could be affected by the proposed changes and the nature of such effects on the ATSS, FINRA, and the SIP.

### **4. Total Initial and Annual Reporting and Recordkeeping Burdens**

The proposed amendments to the CTA Plan and Nasdaq UTP Plan would, if adopted, to varying degrees, increase the collection of information burdens for ATSS, FINRA, and the SIPs.

#### **a. Burden on ATSS**

The Commission understands that all ATSS currently report their transactions to FINRA pursuant to FINRA's rules using an MPID, with some ATSS reporting their transactions using an MPID of their sponsoring broker-dealer, while other ATSS use a unique MPID. The Plan changes would require that each ATS have a unique MPID. Therefore, some ATSS would have to acquire an MPID from FINRA. The Commission preliminarily believes that ATSS that already use a unique MPID would not incur additional collection of information burdens related to the transmission of unique MPIDs. Those ATSS that currently use an MPID of their



sponsoring broker-dealer may incur a de minimis cost in re-programming their systems to substitute the new MPID for the one currently used in transmitting their transactions to FINRA.

The Commission preliminarily believes that this collection of information would not involve any substantive or material change in the burden that already exists as part of the ATSS' ordinary and customary activities in providing MPID information to FINRA in the normal course of business, pursuant to FINRA's rules.<sup>139</sup>

#### **b. Burden on FINRA**

Currently, when FINRA reports transactions to the SIPs, the MPID is dropped from every transaction report and an identifier is appended indicating the trade was executed OTC. Under the proposed amendments, each ATS trade report would carry a unique ATS indicator, in addition to the OTC indicator, unless the trade is a large size trade. FINRA, upon the receipt of an ATS trade report with a unique indicator would retransmit the trade report to the SIP, after excluding the ATS identifier from trade reports for large size trades. FINRA would have to re-program its systems to allow for the trade report message to carry the unique identifier for each ATS and to exclude the identifier for large size trades from the transmission to the SIPs.

The Commission preliminarily estimates that the one-time, initial annualized expense for FINRA for development, including re-programming and testing of the systems would be approximately \$1,175,000.<sup>140</sup>

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<sup>139</sup> See 5 CFR 1320.3(b)(2) (“The time, effort, and financial resources necessary to comply with a collection of information that would be incurred by persons in the normal course of their activities . . . would be excluded from the ‘burden’ if the agency demonstrates that the reporting, recordkeeping, or disclosure activities needed to comply are usual and customary.”).

<sup>140</sup> This figure is the total initial, one-time annualized expense to add unique ATS identifiers to trade report messages transmitted to the SIPs. This figure includes the development and testing expenses of the FINRA/NASDAQ TRF, FINRA/NYSE TRF, and the ADF, to

The Commission preliminarily estimates that the one-time, initial annualized burden for FINRA development, including re-programming and testing of the systems to comply with the proposed amendments to the Plans would be approximately 100 burden hours.<sup>141</sup>

The Commission preliminarily believes that the ongoing annualized expense for FINRA would not result in a burden for purposes of the PRA, as FINRA currently transmits trade report messages to the SIPs in the normal course of business.<sup>142</sup>

**c. Burden on the SIPs**

Currently, the SIPs do not receive an MPID from FINRA for the ATS trades. FINRA removes the MPID and an identifier is appended indicating the trade was executed OTC. Under the proposed Plan amendments, the SIPs would receive from FINRA a trade report identifying the specific ATS on which a trade was executed, unless the trade is a large size trade. The SIPs would need to re-program their systems to allow for the trade report message that carries the unique identifier for each ATS to be received by the SIPs and then later allow for the transmission of the information to the vendors.

The Commission preliminarily estimates that the one-time, initial annualized burden for the Securities Industry Automation Corporation (“SIAC”), which serves as a SIP for the CTA Participants, to comply with the proposed Plan amendments would be approximately 320 burden

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which ATS trades are reported. The figure is based on discussions of Commission staff with FINRA staff.

<sup>141</sup> This figure is based on discussions of Commission staff with FINRA staff. This figure includes the FINRA development and testing. The Commission derived the total estimated one-time burden from the following: [(Programmer Analyst at 25 hours) x 2 + (Computer Operator at 25 hours) x 2] = 100 burden hours.

<sup>142</sup> See supra notes 104 and 139.

hours.<sup>143</sup> This figure is based on the estimated number of hours for SIAC to provide planning, development, implementation, testing, and quality assurance.

The Commission further preliminarily estimates that the one-time, initial annualized burden for the Nasdaq SIP, which serves as a SIP for the UTP Participants, to comply with the proposed Plan amendments would be approximately 800 burden hours.<sup>144</sup> This figure is based on the estimated number of hours for the Nasdaq SIP to develop and test the software and work with the UTP participants and vendors regarding the enhancement.

The Commission preliminarily believes that the ongoing annualized expense for the SIPs would not result in a burden for purposes of the PRA, as SIPs currently transmit trade report messages in the normal course of business.<sup>145</sup>

The Commission seeks comment on the reporting and recordkeeping collection of information burdens associated with the proposed amendments. In particular:

1. Would ATSS incur any collection of information burdens if the proposed Plan amendments were adopted by the Commission? How many ATSS would be required to obtain a new MPID under the proposed Plan amendments? What would be the costs, if any, to an ATSS required to obtain a new MPID to substitute the new MPID for the one it currently uses in transmitting last sale price data to FINRA?

2. What are the burdens, both initial and annual, that FINRA (including the two TRFs and the FINRA ADF) and the SIPs would incur for programming, expanding systems capacity, and establishing compliance programs if the Commission were to adopt the proposed

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<sup>143</sup> This figure is based on discussions of Commission staff with SIAC.

<sup>144</sup> This figure is based on discussions of Commission staff with Nasdaq SIP.

<sup>145</sup> See supra note 86 and accompanying text; see also note 139.

amendments? Would there be additional burdens associated with the collection of information under these proposed Plan amendments?

## **5. Retention Period of Recordkeeping Requirements**

The proposed amendments to the Plans do not contain any new record retention requirements. As an SRO subject to Rule 17a-1 under the Exchange Act, FINRA is required to retain records of the collection of information for a period of not less than five years, the first two years in an easily accessible place.<sup>146</sup>

As registered broker-dealers, all ATSS that would be subject to the proposed amendments are currently required to retain records in accordance with Rule 17a-4 of the Exchange Act.<sup>147</sup>

## **6. Collection of Information is Mandatory**

Any collection of information pursuant to the proposed amendments to the CTA Plan and the Nasdaq UTP Plan would be a mandatory collection of information.

## **7. Responses to Collection of Information Will Not Be Kept Confidential**

The collection of information resulting from the proposed amendments to the CTA Plan and the Nasdaq UTP Plan would not be confidential and would be publicly available.

## **8. Request for Comment**

Pursuant to 44 U.S.C. 3505(c)(2)(B), the Commission solicits comment to:

1. Evaluate whether the proposed collection of information is necessary for the performance of the functions of the agency, including whether the information shall have practical utility;

2. Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

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<sup>146</sup> 17 CFR 240.17a-1.

<sup>147</sup> 17 CFR 240.17a-4.

3. Enhance the quality, utility, and clarity of the information to be collected; and
4. 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 wishing to submit comments on the collection of information requirements should direct them to the following persons: (1) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, OMB, Room 3208, New Executive Office Building, Washington, DC 20503; and (2) Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090 with reference to File No. S7-27-09. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. The Commission has submitted the proposed collection of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-27-09, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE, Washington, DC 20549.

## **VI. Consideration of Costs and Benefits**

### **A. Actionable IOIs**

The Commission is sensitive to the costs and benefits associated with the proposed amendment to the definition of “bid” and “offer” in Rule 600(b)(8) of Regulation NMS to apply expressly to certain actionable IOIs. We request comment on the costs and benefits associated with the proposed amendment. The Commission has identified certain costs and benefits of the

proposal and requests comment on all aspects of its preliminary cost-benefit analysis, including identification and assessments of any costs and benefits not discussed in this analysis. The Commission also seeks comments on the accuracy of any of the benefits identified and also welcomes comments on the accuracy of any of the costs estimates. Finally, the Commission encourages commenters to identify, discuss, analyze, and supply relevant data, information or statistics regarding any such costs or benefits.

### **1. Benefits**

The Commission preliminarily believes that the proposed amendment would benefit market participants by increasing transparency and reducing the potential for a two-tiered market. The Commission also preliminarily believes that the proposed amendment would help encourage displayed liquidity in the form of publicly displayed limit orders.

As discussed above, a number of dark pools transmit IOIs to selected market participants that convey substantial information about their available trading interest.<sup>148</sup> These messages are not included in the consolidated quotation data, although, like displayed quotations, they can be significant inducements for the routing of orders to a particular trading venue. Indeed, some exchanges, when they do not have available trading interest to execute orders at the best displayed prices, give participants a choice of routing their orders to undisplayed venues in response to IOIs rather than to public markets in response to the best displayed quotations.<sup>149</sup>

Although these IOIs may not explicitly specify the price and size of available trading interest at the dark pool, the practical context in which they are transmitted may render them “actionable.” For example, an IOI would be actionable if it effectively alerted the recipient that the dark pool currently has trading interest in a particular symbol, side (buy or sell), size

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<sup>148</sup> See supra note 20.

<sup>149</sup> See supra note 21.

(minimum of a round lot of trading interest), and price (equal to or better than the national best bid for buying interest and the national best offer for selling interest).

This might occur if a dark pool sent an IOI to a group of market participants communicating an interest in buying a specific NMS stock. Given that Rule 611 of Regulation NMS generally prevents trading centers, including dark pools, from executing orders at prices inferior to the national best bid or offer (“NBBO”), the IOI recipient reasonably can assume that the price associated with the IOI is the NBBO or better. Moreover, the IOI may be part of a course of conduct in which the recipient has responded with orders to the sender and repeatedly received executions at the NBBO or better with a size of at least one round lot. With this information (both explicit and implicit), the recipient of the IOI can reasonably conclude that sending a contra-side marketable order responding to the IOI will result in an execution if the dark pool trading interest has not already been executed against or cancelled. In this respect, actionable IOIs are functionally quite similar to displayed quotations at the NBBO.

The order information communicated by actionable IOIs can be extremely valuable. Actionable IOIs with implicit prices better than the NBBO effectively narrow the quoted spread for an NMS stock. For example, if the NBBO for an NMS stock were \$20.10 and \$20.14, an actionable IOI to buy with an implicit price of \$20.12 would, if included in the consolidated quotation data, create a new NBBO of \$20.12 and \$20.14 and thereby reduce the quoted spread by 50%. Reducing quoted spreads is important not only for those that trade with the displayed quotations, but also for other investors including those whose orders are routed to OTC market makers for executions that often are derived from NBBO prices. In addition, actionable IOIs with implicit prices equal to the NBBO can substantially improve the quoted depth at the best prices for an NMS stock. For example, an investor may wish to sell 500 shares of a stock when

the size of the national best bid may be only 100 shares. The existence of multiple dark pools that contemporaneously had transmitted actionable IOIs to buy the stock would represent a substantial increase in the available size at NBBO prices or better.

The public, however, does not have access to this valuable information concerning the best prices for NMS stocks. Rather, dark pools transmit this information only to selected market participants. In this regard, actionable IOIs can create a two-tiered level of access to information about the best prices for NMS stocks that is contrary to the Exchange Act objectives for a national market system.<sup>150</sup> The consolidated quotation data is intended to provide a single source of information on the best prices for a listed security across all markets, rather than force the public to obtain data from many different exchanges and other markets to learn the best prices. This objective is not met if dark pools or other trading venues disseminate pricing information that is functionally quite similar to quotations, yet is not required to be included in the consolidated quotation data. The proposal is designed to promote transparency by requiring that the valuable pricing information provided to selected market participants through actionable IOIs is also made available to the public in the consolidated quotation data.

The Commission also is concerned that the private use of actionable IOIs may discourage the public display of trading interest and harm quote competition among markets. The Commission long has emphasized the need to encourage displayed liquidity in the form of publicly displayed limit orders.<sup>151</sup> Such orders establish the current “market” for a stock and thereby provide a critical reference point for investors. Actionable IOIs, however, often will be executed by dark pools at prices that match the best displayed prices for a stock at another market. In this respect, actionable IOIs at NBBO matching prices potentially deprive those who

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<sup>150</sup> See supra note 59.

<sup>151</sup> See supra note 26.



publicly display their interest at the best price from receiving a speedy execution at that price. The opportunity to obtain the fastest possible execution at a price is the primary incentive for the display of trading interest.<sup>152</sup> Particularly if actionable IOIs continue to expand in trading volume, they could significantly undermine the incentives to display limit orders and to quote competitively, and thereby detract from the efficiency and fairness of the national market system.

Moreover, for market participants that wish to supply liquidity in the form of non-marketable resting orders (such as those that match or improve NBBO prices), actionable IOIs provide a tool to achieve this result without displaying quotations publicly. The availability of these private messages as an alternative means to attract order flow may reduce the incentives of market participants to quote publicly. More generally, actionable IOIs divert a certain amount of order flow that otherwise might be routed directly to execute against displayed quotations in other markets. Given the importance of displayed quotations for market efficiency, the Commission is particularly concerned about additional marketable order flow that may be diverted from the public quoting markets and that could further reduce the incentives for the public display of quotations. The proposal is designed to promote the display of public quotations by eliminating a practice that diverts order flow to private markets and by requiring that actionable IOIs be included in the consolidated quotation data.

By excepting IOIs with a market value of at least \$200,000 that are displayed only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000, the proposal is also tailored to maintain the significant size discovery benefits offered by some trading venues such as block crossing networks. In particular, market participants such as institutional investors would be able to find contra-side trading interest for large size without

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<sup>152</sup> See supra note 27.

causing price impact. In addition, the proposed exception for a targeted size discovery mechanism would provide an opportunity for block crossing networks and other trading venues to offer innovative ways for investors that need to trade in large size to find contra-side trading interest of equally large size.

The Commission seeks comment on the anticipated benefits of the proposed amendment. Would the proposal promote the transparency, fairness, and efficiency of the national market system? Would it promote fair competition among trading venues in NMS stocks? Do commenters believe that the Commission has provided sufficient information about the attributes of an actionable IOI for trading venues to comply with the proposed definition? What is the typical size of an actionable IOI? How many large orders use actionable IOIs? What is the amount of order flow that is diverted from displayed quotations due to actionable IOIs? Please quantify and provide supporting data if possible.

Comment also is requested on the proposed size discovery exclusion from the definition of bid or offer. Would the proposed exclusion promote more efficient trading for investors that need to trade in large size? Is the exclusion narrowly drafted to cover those trading mechanisms that offer valuable size discovery benefits without inappropriately excluding trading interest concerning the best prices and sizes for NMS stocks from the consolidated quotation data? Comment also is requested on whether market value is the appropriate criterion for size, and whether \$200,000 is the appropriate figure. Should this figure be higher or lower? Please explain why. For example, is the \$200,000 figure appropriate for high-priced stocks? Should the exclusion include a size criterion based on number of shares? If yes, should it be 10,000 shares, as in Rule 600(b)(9), or a larger or smaller number of shares? Finally, comment is

requested on whether other criteria for size, such as percentage of average daily share volume in a security, would be more appropriate.

## 2. Costs

The Commission preliminarily anticipates that market participants could incur certain costs if the proposed amendment is adopted. The change in the definition of “bid” and “offer” would affect compliance with Rule 602 of Regulation NMS.<sup>153</sup> “Bid” and “offer” are key terms that determine the scope of Rule 602 of Regulation NMS. In general, Rule 602 requires exchange members and certain OTC market makers to provide their best-priced bids and offers to their respective exchanges and FINRA.<sup>154</sup> The exchanges and FINRA, in turn, are required to make their best bids and offers available in the consolidated quotation data. The Commission does not believe that the amendment to Rule 600(b)(8) would create significant new compliance burdens under Rule 602. Exchange members and OTC market makers would continue to be required to provide their best-priced bids and offers to their respective exchanges and FINRA. The proposed amendment to Rule 600(b)(8) may increase the number of “bids” and “offers” that exchange members and OTC market makers must review to determine their best-priced bids and offers. It is the Commission’s understanding that all exchange members and OTC market makers have systems and procedures in place to make this determination today. As a result, the

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<sup>153</sup> The proposed amendment to Rule 600(b)(8) of Regulation NMS also may affect the obligations imposed by Rule 301(b)(3) of Regulation ATS on ATSs that meet the specified trading volume threshold. Given the current threshold of 5%, the Commission does not believe that the proposed amendment of Rule 600(b)(8) would substantially affect the quoting requirements of ATSs. The proposal to lower the volume threshold contained in Rule 301(b)(3), however, could affect this view. The costs associated with the proposed amendment to Rule 301(b)(3) are discussed below.

<sup>154</sup> Under the definition of “subject security” in Rule 600(b)(73)(ii)(A) of Regulation NMS, an OTC market maker is not required to provide its best bids and offers for an NMS stock if the executed volume of the firm during the most recent calendar quarter comprised one percent or less of the aggregate trading volume for such NMS stock.

Commission believes that any increased burden in determining their best-priced bids and offers due to the inclusion of actionable IOIs in the definition of “bid” and “offer” would not be significant.

The Commission is aware that actionable IOIs may offer benefits to certain market participants. For example, some market participants choose to trade in dark pools in an effort to minimize the effect of their trading on quoted prices. The use of actionable IOIs to attract order flow may increase the amount of volume executed in dark pools and thereby further the trading strategies of these market participants. If actionable IOIs were included in the consolidated quotation data, these types of trading strategies would not be possible because the actionable IOIs themselves would be included in publicly quoted prices. In addition, some market participants may be willing to allow dark pools to transmit information about their actionable orders to selected recipients, but not be willing to provide this information in the consolidated quotation data that is widely disseminated to the public. If adopted, the proposal could cause these market participants to choose not to transmit this information to anyone and thereby reduce available pricing information for an NMS stock (albeit, information that was only privately available).

These potential costs of reduced trading in dark liquidity venues and reduced availability of liquidity information would be mitigated by the availability of the size discovery exception. The Commission recognizes that some trading venues, such as block crossing networks, may use actionable IOIs as part of a trading mechanism that offers significant size discovery benefits. These benefits may be particularly valuable for institutional investors that need to trade efficiently in sizes much larger than those that are typically available in the public quoting markets. These size discovery mechanisms could be rendered unworkable, however, if their IOIs

for large size were required to be included in the consolidated quotation data. Accordingly, the Commission's proposed amendment would exclude certain IOIs with a market value of \$200,000 or more communicated to those reasonably believed to represent equivalent contra-side trading interest from the current definition of "bid" and "offer" in Rule 600(b)(8). This would maintain the significant size discovery benefits offered by certain trading venues. Also, the Commission expects that the compliance costs to restrict communication to large size contra-side trading interest would be minimal because trading venues that offer size discovery mechanisms currently have systems in place to achieve this objective. In particular, these systems typically incorporate minimum trade size functionalities, as well as mechanisms to help assure that the valuable, actionable information concerning a participant's trading interest is transmitted only to those with whom there is a reasonable opportunity for obtaining an execution in large size.

In addition, the Commission expects that the negative effects of requiring actionable IOIs to be included in the consolidated quotation data would be mitigated by the ability of market participants to adapt their trading strategies to the new rules. Higher incentives to display liquidity and alternative forms of competition for order flow also could mitigate any negative effect of the proposal. Customers of dark pools would remain free, as they are entitled to do with quoting venues today, to control the release of their order information.<sup>155</sup> Customers could not, however, consent to the dissemination of order information sufficient for the transmission of an actionable IOI under \$200,000, yet withhold information about their orders from the consolidated quotation data that is made available to the public.

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<sup>155</sup> See supra note 41 and accompanying text.

The Commission generally requests comment on any direct or indirect costs of the proposed amendment and asks commenters to quantify those costs, where possible. In addition, the Commission requests specific comments on the following questions:

1. What are some of the trading strategies that employ actionable IOIs? Is the use of such actionable IOIs in the best interest of these traders and how would the inability to use those actionable IOIs impact traders, markets, or investors more generally? Could similar benefits be achieved through other means?

2. How are market participants likely to change their behavior if actionable IOIs must be included in the consolidated quotation data? What are the likely effects of these changes? For example, would a significant percentage of dark pools that currently use actionable IOIs go completely dark? What would be the effects on traders, markets, and investors were that to occur?

3. How would the proposal affect competition between trading venues?

4. Would the size discovery exception maintain the existing opportunities of block crossing networks and other trading venues to offer benefits to market participants that need to trade in large size? Do these venues currently have systems in place that would enable them to comply at minimal cost with the terms of the exception?

5. To what extent, if at all, would the proposed amendment to Rule 600(b)(8) increase the number of bids or offers that exchange members and OTC market makers would be required to review and report to their respective exchanges and FINRA for inclusion in the consolidated quotation data?

6. To what extent, if at all, would system changes or increases in system capacities be necessary for exchange members or OTC market makers to comply with the requirements of Rule 602, if the Commission were to adopt the proposed amendments to Rule 600(b)(8)?

## **B.     ATS Display Obligations**

The Commission is sensitive to the costs and benefits associated with the proposed amendments to Rule 301(b)(3) of Regulation ATS. The Commission requests comment on the costs and benefits associated with these proposed amendments. The Commission has identified certain costs and benefits of the proposal and requests comment on all aspects of its preliminary cost-benefit analysis, including identification and assessments of any costs and benefits not discussed in this analysis. The Commission also seeks comments on the accuracy of any of the benefits identified and also welcomes comments on the accuracy of any of the cost estimates. Finally, the Commission encourages commenters to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such costs or benefits.

### **1.     Benefits**

The emergence of dark pools as a significant source of liquidity for NMS stocks raises a variety of important policy issues that deserve consideration. Some dark pools transmit actionable IOIs to selected market participants for the purpose of attracting contra-side order flow to the ATS.<sup>156</sup> Such actionable IOIs function quite similarly to displayed quotations and, as a result, dark pools that distribute such actionable IOIs are no longer truly dark; rather they are “lit” to a select group of market participants but dark with respect to the rest of the public. The

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<sup>156</sup> See supra section II (describing the use of actionable IOIs).

Commission preliminarily believes that this practice is creating a two-tiered market and an inequitable distribution of price information.<sup>157</sup>

It has been a longstanding Commission concern to avoid two-tiered markets, whereby certain market participants have access to information or order flow that others do not.<sup>158</sup> The public quote stream is intended to provide a single source of information on the best prices for NMS stocks across all markets, rather than force the public to obtain data from many different exchanges and other trading venues to learn the best prices.<sup>159</sup> This objective is not being met if dark pools or other markets disseminate pricing information that is functionally quite similar to quotations, yet is not required to be included in the public quote stream.<sup>160</sup>

Congress in 1975 endorsed the development of a national market system and granted the Commission broad authority to implement it.<sup>161</sup> Chief among the objectives of the national market system are coordinating markets, reducing fragmentation, and limiting the possibility of tiered markets where the best trading opportunities are available only to selected market participants.<sup>162</sup> As the Commission has long recognized, proper coordination of markets requires

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<sup>157</sup> See id.

<sup>158</sup> See supra section II (describing the purpose of the consolidated quotation data stream).

<sup>159</sup> See id.

<sup>160</sup> See id.

<sup>161</sup> See Pub. L. 94-29, 89 Stat. 97 (1975) (adopting Section 11A of the Exchange Act).

<sup>162</sup> See 15 U.S.C. 78k-1(a)(1)(D) ("The linking of all markets for qualified securities through communication and data procession facilities will foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate the offsetting of investors' orders, and contribute to best execution of such orders.") See also Regulation ATS Proposing Release and Concept Release (citing inter alia SEC, STATEMENT OF THE SECURITIES AND EXCHANGE COMMISSION ON THE FUTURE STRUCTURE OF THE SECURITIES MARKETS (February 2, 1972), 37 FR 5286 (March 14, 1972)); Securities Exchange Act Release No. 36310 (September 29, 1995), 60 FR 52792 (October 10, 1995).



transparency and access across the national market system.<sup>163</sup> Market participants must be able to know where the best trading opportunities exist and have the ability to execute orders in response to those opportunities. The Commission has taken a number of actions designed to further these goals,<sup>164</sup> including by providing, through Regulation ATS, a regulatory framework that permits competition among and innovation by exchange and non-exchange trading centers while attempting to minimize detrimental market fragmentation. As the Commission observed in 1997, the failure "to fully coordinate trading on alternative trading systems into national market systems mechanisms has impaired the quality and pricing efficiency of secondary equity markets. . . . Although these systems are available to some institutions, orders on these systems frequently are not available to the general investing public."<sup>165</sup> The Commission noted that such "hidden markets" – where superior quotations might be available to a subset of market participants – impeded the goals of the national market system.<sup>166</sup>

The proposed amendments to Rule 301(b)(3), together with the proposed changes to Rule 600(b)(8) of Regulation NMS, seek to inhibit the development of "hidden" or partially lit markets that result in a tiered market structure, and thus strengthen the national market system for the benefit of public investors. By more fully coordinating trading on ATSs into the national

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<sup>163</sup> See, e.g., Regulation ATS Proposing Release, supra note 53, 63 FR at 23511.

<sup>164</sup> See supra note 55.

<sup>165</sup> Concept Release, supra note 53, 63 FR at 30492. See also Regulation ATS Proposing Release, supra note 53, 63 FR at 23514.

<sup>166</sup> See Regulation ATS Proposing Release, 63 FR at 23514-15 ("The use of these systems to facilitate transactions in securities at prices not incorporated into the [national market system] has resulted in fragmented and incomplete dissemination of quotation information. Recent evidence suggests that the failure of the current regulatory approach to fully integrate trading on alternative trading systems into [the national market system] mechanisms has impaired the quality and pricing efficiency of secondary equity markets, particularly in light of the explosive growth in trading volume on such alternative trading systems").

market system, the proposed amendments are designed to improve pricing efficiency and execution quality in NMS stocks.

As described above, the Commission is proposing to amend Rule 301(b)(3)(i)(B) of Regulation ATS<sup>167</sup> to reduce the average daily trading volume threshold that would trigger display obligations for an ATS from 5% to 0.25%. The Commission is also proposing to amend Rule 301(b)(3)(ii) of Regulation ATS<sup>168</sup> to clarify that an ATS must publicly display and provide execution access to its best-priced orders in NMS stocks when such orders are displayed to more than one person (other than ATS employees), regardless of whether such persons are subscribers of the ATS. In addition, the Commission is proposing to amend Rule 301(b)(3)(ii) to mirror the proposed exception in the definition of "bid" or "offer" in Rule 600(b)(8) for orders having a market value of at least \$200,000 and which are communicated only to market participants who are reasonably believed to represent current contra-side trading interest of at least \$200,000. Together with the proposal to amend the definition of "bid" or "offer" in Rule 600(b)(8) to explicitly include actionable IOIs, these proposed amendments to Rule 301(b)(3) of Regulation ATS are designed to increase the opportunity for all market participants to discover and interact with the best-priced orders, while offering certain large orders the opportunity for size discovery.

The Commission believes that broker-dealers operating ATSS should be subject to quoting requirements that broadly parallel those applicable to other market participants. Currently, the order display and execution access requirements in Regulation ATS do not apply unless an ATS has an average daily trading volume threshold in an NMS stock of 5% or more. Few if any ATSS exceed the 5% threshold for any NMS stocks although, as explained above,<sup>169</sup>

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<sup>167</sup> 17 CFR 242.301(b)(3)(i)(B).

<sup>168</sup> 17 CFR 242.301(b)(3)(ii).

<sup>169</sup> See supra notes 9 and 10 and accompanying text.

ATSS collectively account for a significant share of trading volume. Many dark pool ATSS communicate order information via actionable IOIs that could, if appropriately integrated, contribute to the overall efficiency and quality of the national market system. Without any attendant change to Regulation ATS to lower the 5% threshold, the proposed amendments to the definitions of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS would have less effect, because most ATSS could continue to communicate actionable IOIs only to selected market participants. Therefore, in conjunction with the proposed amendments to Rule 600(b)(8), the Commission is proposing to substantially lower the threshold at which an ATS incurs an obligation under Regulation ATS to provide orders to an SRO for inclusion in the public quote stream. The Commission preliminarily believes that such amendment would be consistent with the mandate set forth in Section 11A of the Exchange Act<sup>170</sup> to promote a national market system.

The Commission also preliminarily believes that, by expanding the pool of orders that would be required to be incorporated into the consolidated public quote stream, the proposed amendments to Rule 301(b)(3) would have the potential in many cases to narrow the NBBO or to increase the quoted size at the existing NBBO.<sup>171</sup> As noted above, requiring that actionable IOIs be incorporated into the public quote stream is particularly important now given their increasing prevalence.<sup>172</sup> Thus, although 0.25% is only a small portion of average daily trading volume, actionable IOIs sent by even small ATSS, when aggregated, may represent a significant percentage of the orders that would set the price of, or increase the size available at, the

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<sup>170</sup> 15 U.S.C. 78k-1.

<sup>171</sup> See supra section II.

<sup>172</sup> Id.

NBBO.<sup>173</sup> The Commission preliminarily believes that making most such orders visible and available to the market as a whole could represent a substantial benefit to investors.

Furthermore, incorporating the best-priced orders from all but the smallest ATSs into the public quote stream would increase the value of the public quote stream.

The Commission is also proposing to amend Rule 301(b)(3) to include an exception from the order display and execution access requirements for certain large orders, which would mirror the proposed exception with respect to the definition of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS. This exception would apply to orders with a market value of \$200,000 or more that are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000. Pursuant to the proposed exception, an ATS could display these large orders to potential counterparties reasonably believed to represent contra-side trading interest of at least \$200,000 without triggering the order display and execution access requirements of Rule 301(b)(3).

As noted earlier, the Commission recognizes that some trading venues, such as block crossing networks, may use actionable IOIs as part of a trading mechanism that offers significant size discovery benefits.<sup>174</sup> These benefits may be particularly valuable for institutional investors that need to trade efficiently in sizes much larger than those that are typically available in the public quoting markets.<sup>175</sup> These size discovery mechanisms could be rendered unworkable, however, if their narrowly targeted IOIs for large size were required to be included in the public

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<sup>173</sup> See id. (noting dark pools in the aggregate account for 7.2% of aggregate trading volume in the NMS).

<sup>174</sup> See supra Section VI.A.1.

<sup>175</sup> See id.

quote stream.<sup>176</sup> The Commission preliminarily believes that the proposed exception would facilitate greater opportunity for ATS subscribers to discover size without generating adverse market impact.

## 2. Costs

The Commission preliminarily anticipates that ATSs could incur certain costs if the proposed amendments were adopted. Under the proposed amendments, ATSs that display orders in NMS stocks (except for orders that have a market value of at least \$200,000 and are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000) to more than one person, whether by communicating actionable IOIs or otherwise, and meet the proposed average daily trading volume threshold of 0.25% would be subject to the order display and execution access requirements of Rule 301(b)(3) of Regulation ATS.<sup>177</sup>

The Commission does not preliminarily expect that the costs of monitoring daily trade volume associated with the proposed amendments to Rule 301(b)(3) would be significant. Each ATS is already required to monitor its trading volumes. However, ATSs might incur some costs to adjust their current monitoring programs to take account of the proposed reduction in the display threshold from 5% to 0.25%. In addition, as described above, the proposed amendments might impose certain costs, both initial and ongoing, on dark pool ATSs that currently transmit

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<sup>176</sup> See id.

<sup>177</sup> The Commission is not proposing to amend Rule 301(b)(3)(iii) of Regulation ATS. For an ATS that is required to display orders pursuant to Rule 301(b)(3)(ii), Rule 301(b)(3)(iii) requires such ATS to provide to any broker-dealer that has access to the SRO to which the ATS provides the prices and sizes of its best-priced orders 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 SRO; and (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. See 17 CFR 242.301(b)(3)(iii).

actionable IOIs and could be required to change their business models. Likewise, the proposed amendments could impose costs, both initial and ongoing, on any ATS that is currently displaying, or might in the future decide to display, order information and that might, if the Commission adopts the proposed amendments, decide instead to operate as a completely dark ATS. The Commission notes that each ATS could avoid any such costs by not displaying orders at all, or by selectively displaying only large orders that qualify for the proposed exception.

For an ATS that is impacted by the proposed amendment to Rule 301(b)(3), initial adjustment costs could include system re-programming to monitor the ATS's percentage of trading in NMS stocks,<sup>178</sup> establishing linkages to an SRO for the purpose of submitting orders to the SRO for public display and of providing access to market participants wishing to trade against such orders, and expanding systems capacity and internal controls, including establishing or modifying applicable compliance policies and procedures, to carry out these functions in a manner consistent with the SRO's rules. The Commission preliminarily believes that such adjustment costs could include ATS staff time to build new systems or re-program current systems, as well as ongoing ATS staff time to maintain such systems and carry out their associated functions.

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<sup>178</sup> Currently, under Rule 301(b)(3) of Regulation ATS, an ATS that displays subscriber orders to any person (other than ATS employees) and has 5% or more of the aggregate daily share volume for an NMS stock is required to provide to an SRO its best-priced orders for such NMS stock for inclusion into the public quote stream. Thus, ATSs are already required to monitor trading levels in NMS stocks. As a result of the proposed amendments to Rule 301(b)(3), which would lower the average daily trading volume threshold from 5% to 0.25%, ATSs could be required to re-program their respective systems that monitor trading levels in NMS stocks to reflect the lower threshold. Based on discussions of Commission staff with certain potential ATS respondents and other market participants, the Commission preliminarily believes that costs of such re-programming would not be significant, although it requests comment on that point.

For purposes of the PRA, the Commission preliminarily estimated that the initial annualized expense for all potential ATS respondents to establish connectivity to an SRO would be approximately \$3,900,000.<sup>179</sup> In addition, the Commission preliminarily estimated that the initial annualized expense to comply with the proposed amendments to Rule 301(b)(3) would be approximately \$3,815,520.<sup>180</sup> This figure is based on the estimated number of hours and hourly costs<sup>181</sup> for initial internal development and implementation by an ATS to re-program the system, expand the system capacity, and adjust internal controls, including costs to establish or modify applicable compliance policies and procedures for an initial implementation period of two months, plus the estimated costs associated with running compliance policies and procedures (including monitoring daily trading activity), ongoing system maintenance and development, and estimated internal costs associated with maintaining connectivity to an SRO, and ensuring compliance for a period of ten months, multiplied by 12 (the Commission's estimate of the number of potentially impacted ATSs).

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<sup>179</sup> See supra note 130.

<sup>180</sup> This figure is based on discussions of Commission staff with certain potential ATS respondents and other market participants. The Commission derived the total estimated initial annualized expense from the following: [(Sr. Programmer (320 hours) at \$292 per hour) + (Compliance Manager (20 hours) at \$258 per hour) + (Compliance Attorney (20 hours) at \$270 per hour) + (Programmer Analyst (20 hours) at \$193 per hour) + (Sr. Systems Analyst (30 hours) at \$244 per hour)) x (2 months) + ((Sr. Programmer (2 hours) at \$292 per hour) + (Compliance Manager (6 hours) at \$258 per hour) + (Compliance Attorney (4 hours) at \$270 per hour) + (Compliance Clerk (40 hours) at \$63 per hour) + (Sr. Systems Analyst (2 hours) at \$244 per hour) + (Director of Compliance (5 hours) at \$388 per hour) + (Sr. Computer Operator (8 hours) at \$75 per hour)) x (10 months)] x (12 potential ATS respondents) = \$3,815,520.

<sup>181</sup> Hourly figures are from SIFMA's Management & Professional Earnings in the Securities Industry 2008 and SIFMA's Office Salaries in the Securities Industry 2008, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 or 2.93, as appropriate, to account for bonuses, firm size, employee benefits, and overhead.

The Commission also preliminarily estimated the ongoing expenses of complying with the proposed amendments to Rule 301(b)(3), which could include, among other things, maintaining connectivity with an SRO, monitoring daily trade activity, and ensuring compliance. For purposes of the PRA, the Commission preliminarily estimated that the ongoing annualized expense for all potential ATS respondents to maintain connectivity to an SRO would be approximately \$3,600,000.<sup>182</sup> In addition, the Commission preliminarily estimated that the ongoing annualized expense for all potential ATS respondents to comply with the proposed amendments to Rule 301(b)(3) would be approximately \$1,261,440.<sup>183</sup> This figure is based on the estimated number of hours and hourly costs<sup>184</sup> for running compliance policies and procedures (including monitoring daily trading activity), ongoing system maintenance and development, and estimated internal costs associated with maintaining connectivity to an SRO, and ensuring compliance for a period of 12 months, multiplied by 12 (the Commission's estimate of the number of potentially impacted ATSs).

The Commission is also proposing a change to Rule 301(b)(3)(ii) that would add an exception to the order display and execution access requirements for orders that have a market value of at least \$200,000 and are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000. The Commission preliminarily

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<sup>182</sup> See supra note 132.

<sup>183</sup> This figure is based on discussions of Commission staff with certain potential ATS respondents and other market participants. The Commission derived the total estimated ongoing burdens from the following: ((Sr. Programmer (2 hours) at \$292 per hour) + (Compliance Manager (6 hours) at \$258 per hour) + (Compliance Attorney (4 hours) at \$270 per hour) + (Compliance Clerk (40 hours) at \$63 per hour) + (Sr. Systems Analyst (2 hours) at \$244 per hour) + (Director of Compliance (5 hours) at \$388 per hour) + (Sr. Computer Operator (8 hours) at \$75 per hour)) x (12 months) x (12 potential ATS respondents) = \$1,261,440.

<sup>184</sup> See supra note 181.



believes that an ATS would not incur any costs relating to order display and execution access because of the proposed exception. An ATS would incur either the same costs as it would otherwise (because it communicated no orders that met the terms of the proposed exception) or fewer costs (because some or all of the orders that it communicated met the terms of the proposed exception, thus reducing the number of orders that would otherwise have to be publicly disseminated under the proposed amendments to Rule 301(b)(3)). Each ATS is already required under Rule 301(b)(3) to monitor its order flow; the Commission preliminarily believes that tracking which orders qualify for the proposed exception would require no additional costs beyond those otherwise required, although it requests comment on that point.

The proposed amendments to Rule 301(b)(3) of Regulation ATS are designed to balance the benefits of technology and flexible regulation with the need for appropriate coordination among trading centers. The Commission understands that linkage costs have fallen substantially since it adopted Regulation ATS. Nevertheless, the Commission is sensitive to the costs of its regulation and the proposed amendments on current and new ATSs, as well as the potential effect on their development. The Commission preliminarily believes that reducing the average daily trading volume threshold to 0.25% would provide an appropriate level under which ATSs could display subscriber orders to more than one person (whether by sending actionable IOIs or otherwise) without imposing substantial costs associated with linking to an SRO.

Consistent with the reasons enunciated in the Regulation ATS Adopting Release for establishing the 5% threshold and as discussed in this release, the Commission preliminarily believes that proposing a reduction of the ATS display threshold to 0.25% is warranted at this time. The Commission also preliminarily believes that the goals and objectives of lowering the threshold justify the costs associated with linking to an SRO. For ATSs that would be subject to

the order display and execution requirements if the Commission were to adopt the 0.25% threshold, the Commission preliminarily believes that the current costs of linking to an SRO are not significant.<sup>185</sup> Communications and order-routing systems have improved significantly since Regulation ATS was originally adopted. Robust and extremely fast linkages that were not available at that time are now widely offered on commercially reasonable terms, and the market for these services is highly competitive, further reducing their cost.<sup>186</sup>

In addition, the Commission preliminarily believes that the proposed amendments to Rule 301(b)(3) of Regulation ATS would not, if adopted, impose any substantive or material costs on SROs under the requirements of Rule 602 of Regulation NMS. Under the proposal, order information that is communicated by ATSs to more than one person outside the public quote stream (whether via actionable IOIs or otherwise) could be required to be incorporated into the public quote stream. As described above, to accomplish this, the ATS would be required to send the order information to an SRO, and that SRO would be responsible under Rule 602 for the incorporation of the information in the consolidated public quote stream. The Commission preliminarily believes that any costs associated with including such ATS orders with the large volume of quotations that SROs already include in the public quote stream under Rule 602 would not be material.

As noted previously, an ATS that sends actionable IOIs or otherwise displays subscriber orders to more than one person (other than ATS employees) and exceeds the proposed 0.25% threshold for an NMS stock could avoid the direct costs of linking to an SRO by going completely dark. The Commission recognizes that such a choice could be viewed as a potential

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<sup>185</sup> This information is based on discussions of Commission staff with certain potential ATS respondents and other market participants.

<sup>186</sup> See id.

cost of the proposed amendments. An ATS that, under the existing 5% threshold, generates contra-side interest for its subscriber orders by communicating actionable IOIs might – if it ceased to do so – effect fewer executions, which could lead to a loss of revenue and market share for the ATS. The Commission is sensitive to this potential cost, but preliminarily believes that it would be mitigated by the proposed exception for size discovery orders and justified by the overall benefits of the proposal to the national market system.

The proposed amendment to Rule 301(b)(3) could also impose costs on ATS subscribers that currently receive executions arising from ATSs' use of actionable IOIs. If the proposal is adopted, such subscribers might incur costs to re-evaluate their order execution strategies. For example, if a subscriber currently uses an ATS that communicates actionable IOIs, and the ATS is above the proposed display threshold of 0.25% in one or more NMS stocks, the subscriber would have to evaluate whether it is better served by having its orders in displayed markets or in completely dark pools. The strategies that they adopt in response to the proposal might not be as profitable as those they are employing currently. In addition, market participants that currently receive actionable IOIs might no longer have access to such trading opportunities and could incur costs to adapt their strategies if the number of IOIs that they receive decreases.

Nevertheless, the Commission preliminarily believes that the costs to such subscribers and to recipients of actionable IOIs would be justified by the benefits to the national market system as a whole. For the reasons discussed in this release, the Commission preliminarily believes that the proposal would reduce the possibility of a tiered market structure and provide better access for all investors to the best-priced orders in NMS stocks. This outcome would benefit all market participants.

The Commission requests comment on the costs and benefits of the proposed amendments to Rule 301(b)(3) of Regulation ATS discussed above, as well as any costs and benefits not already described which could result from them. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests specific comment on the following questions:

1. Currently, ATSs can display orders in NMS stocks to more than one person without triggering the order display and execution access requirements in Rule 301(b)(3) if they do not exceed the 5% threshold. Under the proposed amendments to Rule 301(b)(3), many ATSs would lose the ability to display orders in this manner, and would have to either publicly display those orders or go completely dark. What are the costs and benefits of eliminating the ability of ATSs to communicate actionable IOIs to only a limited group?

2. Would the proposed amendments likely result in an increase in the number of ATSs that submit their best-priced orders to an SRO for inclusion in the public quote stream? Why or why not? What benefits would result from more ATSs submitting their best-priced orders in NMS stocks to an SRO for inclusion in the public quote stream? Can those benefits be quantified? If so, how? What are the potential adverse effects?

3. If ATSs respond to the proposed amendments by going completely dark, what costs or benefits would result for: (a) those ATSs, (b) market participants that currently receive actionable IOIs from those ATSs, and (c) the national market system as a whole?

4. For ATSs that would choose to respond to the proposed amendments by submitting their best-priced orders in NMS stocks to an SRO for inclusion in the public quote stream, what are the costs of establishing the necessary linkages to an SRO? To what extent do those ATSs already have the capability to submit orders to an SRO? Could existing systems and

communications infrastructure be adapted for that purpose and, if so, at what cost? Please describe and quantify in terms of both initial and ongoing costs.

5. What would be the costs and benefits of setting the display threshold at 0.25%? Would this change achieve the Commission's goals of increasing price competition in the national market system? Why or why not? Would there be greater benefits to the market as a whole by eliminating the threshold altogether (i.e., setting the threshold at 0%) and thereby requiring any ATS that displays a subscriber order to more than one person to include that order in the public quote stream?

6. What costs would be imposed on new ATSs if the Commission were to adopt the proposed 0.25% threshold or to eliminate it entirely? Would a low or no threshold create a barrier to entry for new ATSs? Why or why not?

7. Under the proposed amendments, an ATS could continue to communicate customer orders in NMS stocks outside the public quote stream if those orders had a market value of at least \$200,000 and were displayed only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000. What would be the benefits of allowing such display by ATSs of these orders? Would the execution quality of such orders decline if they instead had to be placed (either in full or in smaller pieces) in displayed markets or completely dark pools? What are the costs to the market of allowing such orders to be displayed by ATSs without requiring their inclusion in the public quote stream?

### **C. Post-Trade Transparency for ATSs**

The Commission is sensitive to the costs and benefits associated with the proposed Plan amendments. The Commission has identified certain costs and benefits of the proposed Plan amendments and requests comment on all aspects of this cost-benefit analysis, including

identification and assessment of any costs and benefits not discussed in the analysis. The Commission seeks comment and data on the value of the benefits identified. The Commission also requests those commenters to provide data so the Commission can improve the cost estimates, including identification of statistics relied on by commenters to reach conclusions on cost estimates.

## **1. Benefits**

The proposed Plan amendments would require the disclosure of the identity of ATSS on their trade reports in the public data stream to improve post-trade transparency. The proposed Plan amendments would require that all ATSS subject to Regulation ATS use a unique identifier, and would require that the identity of the ATS that executed a trade be included in the public data stream. The Commission believes this proposal to improve post-trade transparency would enhance public confidence in the securities markets by providing accurate information regarding the volume of transactions effected by ATSS as trading venues. This disclosure of information would provide the marketplace with a more complete and accurate picture of trading activity in ATSS thereby improving the quality and pricing efficiency of the equity markets. The Commission preliminarily believes that such information would help investors to assess trading volume of ATSS (including ECNs and dark pools) and to evaluate which ATSS may have liquidity in particular stocks, enabling orders to be more efficiently routed to trading venues. ATSS with more liquidity may receive additional orders from investors. The proposed Plan amendments are intended to address the Commission's long held belief that transparency promotes efficient securities markets.<sup>187</sup>

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<sup>187</sup> The Commission has held the view that transparency not only allows all market participants to assess overall supply and demand, but also counteracts the effects of fragmentation without forcing all executions into one market. In particular, transparency

Commenters should provide specific data and analysis to support any comments they submit with respect to these benefit estimates.

## 2. Costs

The Commission believes that ATSS would not incur significant costs in connection with the proposed Plan amendments in addition to those already created by the requirements of Rule 601 of the Exchange Act.<sup>188</sup> Currently FINRA rules require each trade to include an MPID. The Commission understands that some ATSS report their transactions using an MPID of their sponsoring broker-dealer, while other ATSS use a unique MPID. The Plan changes would require that each ATSS have a unique MPID, necessitating some ATSS to acquire an MPID from FINRA. ATSS can obtain an additional MPID from FINRA at no cost.<sup>189</sup> Those ATSS that currently use an MPID of their sponsoring broker-dealer could incur a de minimis cost in re-programming their systems to substitute the new MPID for the one currently used in transmitting their transactions to FINRA.

FINRA, upon receipt of this unique indicator would retransmit the trade report to the SIP, after excluding the ATSS identifier from trade reports for large size trades. For purposes of the PRA, the Commission preliminarily estimated that the initial annualized expense for the FINRA/NASDAQ TRF, FINRA/NYSE TRF, and the ADF would be approximately

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reduces the information gap between investors with differing degrees of sophistication because all investors can monitor the quality of executions they receive. Additionally, the Commission has held the view that transparency reduces the likelihood of transactions at non-competitive prices and provides more immediate and useful information for investigating questionable conduct. See supra note 108.

<sup>188</sup> See supra, note 84.

<sup>189</sup> See FINRA Rules 6160 and 6170.

\$1,175,000.<sup>190</sup> In addition, the Commission preliminarily estimated that the initial annualized expense for FINRA internal development and testing would be approximately \$13,400.<sup>191</sup> Therefore, the grand total of the one-time, initial annualized expense for FINRA's development, re-programming, and testing of the systems to comply with the proposed Plan amendments would be approximately \$1,188,400. The Commission preliminarily believes that the ongoing annualized expense for FINRA would be de minimis, as FINRA currently transmits trade report messages to the SIPs in the normal course of business.

The SIPs (SIAC and Nasdaq SIP) would need to modify their trade report message to carry the unique identifier for each ATS. Currently, when transactions are reported to the SIP by FINRA, the MPID is dropped and an identifier is appended indicating the trade was executed OTC. Under the proposed Plan amendments, each ATS trade report would carry an ATS indicator, in addition to the OTC indicator, unless the trade is a large size trade. The Commission preliminarily estimated that the initial annualized expense for SIAC and Nasdaq SIP would be approximately \$175,000.<sup>192</sup> The Commission preliminarily believes that the ongoing annualized expense for the SIPs would be de minimis, as the SIPs currently transmit

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<sup>190</sup> This figure is the total initial, one-time annualized expense to add unique ATS identifiers to trade report messages transmitted to SIPs. This figure includes the development and testing expenses of the FINRA/NASDAQ TRF, FINRA/NYSE TRF, and the ADF, to which ATS trades are reported. The figure is based on discussions of Commission staff with FINRA staff. See supra section V.C.4.b.

<sup>191</sup> This figure is based on discussion of Commission staff with FINRA staff. This figure includes FINRA internal development and testing. The Commission derived the total estimated one-time burdens from the following: [(Programmer Analyst at 25 hours) x 2 at \$193 per hour] + [(Computer Operator at 25 hours) x 2 at \$75 per hour] = \$13,400. See supra section V.C.4.b.

<sup>192</sup> This figure is the total initial, one-time annualized expense to provide planning, development, implementation, testing, and quality assurance for the SIPs. The figure is based on discussions of Commission staff with SIAC and Nasdaq SIP staff. See supra section V.C.4.c.



trade report messages in the normal course of business. The Commission notes that the proposed Plan amendments could affect order routing as investors may choose to change their routing strategies based on the additional disclosure under the proposed amendments of the ATS where the trade was executed.

The Commission generally requests comment on all aspects of these cost estimates for the proposed amendments to the Plans. Commenters should provide specific data and analysis to support any comments they submit with respect to these cost estimates.

## **VII. Consideration of Burden on Competition, and Promotion of Efficiency, Competition and Capital Formation**

Section 3(f) of the Exchange Act<sup>193</sup> requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act<sup>194</sup> requires the Commission, when making rules under the Exchange Act, to consider the impact of such rules on competition. Section 23(a)(2) also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. As discussed below, the Commission’s preliminary view is that the proposed amendments should promote efficiency and competition. It preliminarily believes that the proposals would have minimal impact, if any, on promotion of capital formation.

### **A. Actionable IOIs**

The proposed amendment to the definition of “bid” or “offer” in Rule 600(b)(8) of Regulation NMS would expressly limit its exclusion of IOIs to those “that are not actionable”

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<sup>193</sup> 15 U.S.C. 78c(f).

<sup>194</sup> 15 U.S.C. 78w(a)(2).

and those that are actionable but involve a market value of at least \$200,000 that are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000. The definition of bid or offer is a key element in determining the public quoting requirements of exchanges and OTC market makers. As discussed above, the proposed amendments are designed to help promote fair competition by providing a definition of “bid” or “offer” that would apply to all types of trading venues and, thereby, treat actionable IOIs similarly in those venues. The proposal is further designed to promote competition and enhance efficiency by including all actionable IOIs in the consolidated quotation stream, thereby eliminating the potential that IOIs create for two-tiered access to information on the best prices for NMS stocks. Given that actionable IOIs provide explicit or implicit information regarding symbol, side (buy or sell), size and price, there is little practical reason to treat actionable IOIs differently from displayed quotations at the NBBO.

Currently, dark pools’ IOIs often are executed at prices that match the best displayed prices for a stock at another market, potentially depriving those who publicly display their interest at the best price from receiving a speedy execution at that price. The opportunity to obtain the fastest possible execution at a price is the primary incentive for the display of trading interest.<sup>195</sup> If adopted, the proposal could encourage the public display of trading interest and promote quote competition among markets by eliminating a practice that diverts order flow to private markets. Increasing the volume of order flow routed to public quoting markets could reward market participants for displaying their trading interest, thus leading to an increase in the display of trading interest. Such a result would be consistent with the Commission’s emphasis

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<sup>195</sup> See NMS Release, *supra* note 26.

on the need to encourage displayed liquidity – a critical reference point for investors.<sup>196</sup>

Moreover, increasing the volume of order flow directed to public quotations could increase the incentives for markets to compete by displaying the quotations that would attract such order flow. The proposal thereby could promote competition for the displayed liquidity that is vital to the fairness and efficiency of the market for NMS stocks. Encouraging the use of displayed limit orders could help improve the price discovery process, and in turn, contribute to increased liquidity and depth in the market.<sup>197</sup>

Further, the proposed amendment to the current definition of “bid” or “offer” would exclude any IOIs “for a quantity of NMS stock having a market value of at least \$200,000 that are communicated only to those who are reasonably believe to represent current contra-side trading interest of at least \$200,000.” This exception is designed to benefit investors trading in large sizes by allowing them to trade more efficiently than they could if these quotes were required to be included in the public quotation stream. As discussed above, some trading venues may use actionable IOIs as part of a trading mechanism that locates contra-side trading interest for large size orders without causing price impact on the markets. It also could promote competition by enabling trading venues to continue to offer existing size discovery mechanisms, as well as leaving room for trading venues to innovate and offer additional types of size discovery mechanisms.

Based on the analysis above, the Commission preliminarily believes that the proposed amendment to the definition of “bid” or “offer” in Rule 600(b)(8) to apply expressly to

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<sup>196</sup> See supra note 26.

<sup>197</sup> See Order Handling Rules Release, supra note 26, at 48293 (“[T]he display of customer limit orders advances the national market system goal of the public availability of quotation information, as well as fair competition, market efficiency, best execution, and disintermediation.”).

actionable IOIs would not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The Commission also believes, as discussed above, that the proposed amendment would promote efficiency and competition, and would have minimal impact, if any, on promotion of capital formation.

The Commission requests comment on all aspects of this analysis and, in particular, on whether the proposed amendment would place a burden on competition, as well as the effect of the proposal on efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views if possible.

### **B.     ATS Display Obligations**

As discussed above, the proposed amendments to Rule 301(b)(3) are intended to reduce the potential for two-tiered markets and further integrate the best-priced orders available on ATSs into the national market system. By revising the order display and execution access requirements in Rule 301(b)(3) to reflect proposed revisions to the definition of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS, the Commission aims to foster greater price transparency, more vigorous competition, and stronger, more integrated markets.<sup>198</sup>

ATSs that currently use actionable IOIs could respond to the proposed amendments to Regulation ATS by displaying some of these orders in the public quote stream. The proposed amendments to Rule 301(b)(3) are designed to incorporate more order information into the public quote stream and promote quote competition. Actionable IOIs communicated by ATSs to selected market participants often provide important pricing information and could improve the NBBO or add to the size available at the NBBO if they were included in the public quote stream. Both of these impacts could improve the pricing efficiency and overall execution quality

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<sup>198</sup>     See supra section II.

available in the national market system. Requiring more such IOIs to be integrated into the public quote stream also could further competition among orders and among markets.

ATSs that currently use actionable IOIs could respond to the proposed amendments to Regulation ATS by going completely dark. This outcome could reduce the potential benefits to efficiency and quote competition. Nevertheless, this response would reduce the likelihood of two-tiered markets, where some market participants have information about and access to the best-priced orders that others do not. In addition, such a response would reduce the fraction of order flow that is diverted from market participants that publicly display their interest.

Moreover, the Commission preliminarily believes that the proposed amendments to Rule 301(b)(3) would strike an appropriate balance between encouraging competition among market centers and the need for appropriate coordination among them. The Commission's proposal to lower the trading volume threshold in Rule 301(b)(3) from 5% to 0.25% is designed to recognize significant changes in market structure and practice among market participants that have occurred since Regulation ATS was adopted, while at the same time not lowering the volume threshold to a level that would create an inappropriate barrier to entry for new ATSs.

The Commission also preliminarily believes that, by keeping barriers to entry reasonably low for new ATSs and strengthening the national market system, the proposed amendments to Rule 301(b)(3) would promote competition. A significant number of ATSs have been launched since the Commission adopted Regulation ATS in 1998. Competition between ATSs and exchanges, and between ATSs, has yielded numerous benefits for investors and the national market system as a whole, including faster and more robust trading technology, new trading strategies, and lower transaction costs, which in turn support highly liquid markets with wide

investor participation. The Commission thus believes that reasonably low barriers to entry for ATSS has generally helped to promote competition and efficiency.

For these reasons, the Commission preliminarily believes that the changes to Rule 301(b) would likely have a positive impact on competition and efficiency, would have minimal impact, if any, on promotion of capital formation, and would not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The Commission generally requests comment on the competitive effects of the proposed amendments to Rule 301(b)(3) on any market participant. The Commission also requests comment on what impact the proposed amendments to Rule 301(b)(3) would have on competition, efficiency, and capital formation. The Commission requests comment on all aspects of this analysis and, in particular, on whether the proposed amendments to Rule 301(b)(3) would place a burden on competition, as well as the effect of the proposal on efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views, if possible.

### **C. Post-Trade Transparency for ATSS**

The Commission's preliminary view is that the proposed amendments to post-trade transparency requirements for ATSS should promote efficiency and competition. The Commission believes that the proposed amendments to the Plans would improve post-trade transparency as Plan Participants would be required to include identifying information, specifying the trading center that executed the trade in the consolidated data stream disseminated to the public. This information should lead to more efficient order routing, as investors would know on which ATS a particular security has been traded. This improved post-trade transparency should promote competition among trading venues as the public would be better able to assess where trading volume is being executed. Furthermore, such uniform and reliable

reporting practices may promote efficiency by facilitating the flow of information among ATSS, broker-dealers, exchanges, investors, and other market participants. As discussed, the Commission preliminarily believes that this change would bring the trade reporting requirements for ATSS in line with the trade reporting requirements for exchanges. Requiring the public disclosure of which ATS executed a trade should enable the public to determine more accurately the volume of executions occurring on any particular ATS, as well as on ATSS in general. The Commission expects that investors would direct orders to ATSS that provided liquidity in a particular issue. Greater transparency should also enhance the ability of investors to receive best execution for their orders. Transparency should result in more efficient routing of orders to venues with liquidity. The Commission preliminarily believes that some ATSS could receive additional trading interest when investors are able to identify that the ATS has liquidity in a particular stock.

The Commission preliminarily believes the proposed Plan amendments would promote efficiency and competition and would have minimal impact, if any, on promotion of capital formation. In addition, the Commission preliminarily believes that the proposed Plan amendments would not impose any burden on competition not necessary or appropriate in the furtherance of the purposes of the Exchange Act.

The Commission requests comment on all aspects of this analysis and, in particular, on whether the proposed amendments would place a burden on competition, as well as the effect of the proposal on efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views if possible.

## **VIII. Consideration of Impact on the Economy**

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or “SBREFA,”<sup>199</sup> the Commission must advise the OMB as to whether the proposed regulation constitutes a “major” rule. Under SBREFA, a rule is considered “major” where, if adopted, it results or is likely to result in: (1) an annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease); (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation. If a rule is “major,” its effectiveness will generally be delayed for 60 days pending Congressional review.

The Commission requests comment on the potential impact of the proposed rule amendments on the economy on an annual basis, on the costs or prices for consumers or individual industries, and on competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

## **IX. Regulatory Flexibility Act**

The Regulatory Flexibility Act (“RFA”)<sup>200</sup> requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)<sup>201</sup> of the Administrative Procedure Act,<sup>202</sup> as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on “small entities.”<sup>203</sup> Section 605(b) of the RFA states

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<sup>199</sup> Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

<sup>200</sup> 5 U.S.C. 601 et seq.

<sup>201</sup> 5 U.S.C. 603(a).

<sup>202</sup> 5 U.S.C. 551 et seq.

<sup>203</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



that this requirement shall not apply to any proposed rule or proposed rule amendment, which if adopted, would not “have a significant economic impact on a substantial number of small entities.”<sup>204</sup>

**A. Actionable IOIs**

Pursuant to Rule 605(b) of the RFA, the Commission certifies that the proposed amendment of Rule 600(b)(8) of Regulation NMS, if adopted, would not have a significant economic impact on a substantial number of small entities. The proposed amendment of Rule 600(b)(8) of Regulation NMS would revise the definition of “bid” or “offer” by expressly limiting its exclusion of IOIs to those “that are not actionable and indications of interest for a quantity of NMS stock having a market value of at least \$200,000 that is communicated only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000.” The practical result of the amendment would be that actionable IOIs that do not meet the size discovery exclusion would be “bids” or “offers.”

“Bid” and “offer” are key terms that determine the scope of Rule 602 of Regulation NMS. In general, Rule 602 requires exchange members and OTC market makers to provide their best-priced bids and offers to their respective exchanges and FINRA. The exchanges and FINRA, in turn, are required to make their best bids and offers available in the consolidated quotation data. The exchanges subject to the requirements of Rule 602 are not small entities as defined by Commission rules,<sup>205</sup> and FINRA, a national securities association, is not a small entity.

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RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10. See Securities Exchange Act Release No. 18451 (January 28, 1982), 47 FR 5215 (February 4, 1982) (File No. AS-305).

<sup>204</sup> See 5 U.S.C. 605(b).

<sup>205</sup> See 17 CFR 240.0–10(e).

The proposed amendment to Rule 600(b)(8) could increase the number of “bids” and “offers” exchange members and certain OTC market makers must review to determine their best-priced bids and offers. Some exchange members and OTC market makers may be small entities pursuant to Rule 0-10(c) under the Exchange Act.<sup>206</sup> It is the Commission’s understanding that all exchange members and OTC market makers currently have systems and procedures in place to determine their best-priced bids and offers. As a result, the Commission believes that the proposed amendment would not result in a significant economic impact on a substantial number of exchange members and OTC market makers when determining their best-priced bids and offers due to the proposed inclusion of actionable IOIs in the definition of “bid” or “offer.”

The Commission encourages written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

#### **B. ATS Display Obligations**

The Commission also certifies that the proposed amendments to Rule 301(b)(3) of Regulation ATS would not, if adopted, have a significant economic impact on a substantial number of small entities.

For purposes of Commission rulemaking in connection with the RFA, a small entity includes a broker-dealer with 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>207</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

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<sup>206</sup> See 17 CFR 240.0–10(c).

<sup>207</sup> See 17 CFR 240.17a-5(d).

shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.<sup>208</sup> An entity that complies with Regulation ATS must, among other things, register as a broker-dealer.<sup>209</sup> Thus, the Commission's definition of small entity as it relates to broker-dealers also applies to ATSS.

The proposed amendments to Rule 301(b)(3) would lower the average daily trading volume threshold that triggers the order display and execution access requirements applicable to ATSS. Accordingly, the proposed amendments to Rule 301(b)(3) could result in more ATSS being subject to these requirements.

The Commission notes that there are approximately 73 ATSS that are subject to Regulation ATS. Of these, approximately 11 communicate actionable IOIs in NMS stocks to more than one person and approximately one other ATS displays subscriber orders in NMS stocks on a limited basis in some other fashion. Therefore, the Commission preliminarily believes that approximately 12 respondents could be impacted by the proposed amendments to Rule 301(b)(3).<sup>210</sup> The Commission preliminarily does not believe that any of these 12 ATSS would be a "small entity" as defined above.<sup>211</sup> Therefore, the Commission certifies that the

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<sup>208</sup> See 17 CFR 240.0-10(c).

<sup>209</sup> See 17 CFR 242.301(b)(1).

<sup>210</sup> The Commission preliminarily believes that the remaining 61 ATSS would not be affected by the proposed amendments because they: (a) do not display subscriber orders in NMS stocks to more than one person (whether by communicating actionable IOIs or otherwise), (b) are ECNs and already publicly display subscriber orders, or (c) do not effect transactions in NMS stocks.

<sup>211</sup> This preliminary estimate is based on discussions with industry participants, including ATSS that could be impacted by the proposed changes to Rule 301(b)(3) and information provided in Forms ATS and ATS-R, as filed with the Commission. The Commission notes that most of the 12 potential ATS respondents are affiliated with large broker-dealer firms, none of which is a "small entity" under the RFA.

proposed amendments to Rule 301(b)(3), if adopted, would not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

The Commission encourages written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

### **C. Post-Trade Transparency for ATSS**

The Commission also certifies that the proposed amendments to the CTA Plan and Nasdaq UTP Plan, would not, if adopted, have a significant economic impact on a substantial number of small entities.

Rule 608,<sup>212</sup> adopted by the Commission under Section 11A, establishes procedures for proposing amendments to national market system plans such as the CTA Plan and the Nasdaq UTP Plan. Paragraph (b)(2) states that the Commission may propose amendments to an effective national market system plan by publishing the text of the amendment together with a statement of purpose of the amendments.

The CTA Plan and the Nasdaq UTP Plan amendments apply to the twelve Plan Participants, none of which is a small entity. The requirement for trade reports to now include a unique identifier for ATS transactions, which would be included on the trade reports in the public data stream, would require FINRA, for trades effected by ATSS, to include an additional data element in the trade report that is submitted to the SIPs. FINRA, a national securities association, and the SIPs are not small entities.

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<sup>212</sup> 17 CFR 242.608

The Commission's definition of small entity as it relates to broker-dealers also applies to ATSS.<sup>213</sup> The Commission preliminarily believes that there would be no significant economic impact on any of the 73 ATSS that are subject to Regulation ATS that meet the definition of small entity as defined above. Currently, the identity of an ATS transaction is not disseminated with the trade information they report to the public data stream. The CTA Plan and the Nasdaq UTP Plan amendments would require that each ATS use a unique MPID to report its transactions to FINRA, rather than report its transactions using the MPID of its sponsoring broker-dealer. The ATSS that do not already use a unique MPID would need to replace the MPID for their sponsoring broker-dealer with a unique MPID at no significant economic cost to the ATS. Therefore, the Commission certifies that the proposed amendments to the Plans, if adopted, would not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

The Commission encourages written comments regarding this certification. The Commission requests that commenters describe the nature of any effect on small entities and provide empirical data to support the extent of the impact.

## **X. Statutory Authority**

Pursuant to the Exchange Act and particularly, Sections 2, 3(b), 5, 6, 11, 11A, 15, 15A, 17(a) and (b), 19, 23(a), and 36 thereof, 15 U.S.C. 78b, 78c(b), 78e, 78f, 78k, 78k-1, 78o, 78o-3, 78q(a) and (b), 78s, 78w(a), and 78mm, the Commission proposes to amend Rule 600 of Regulation NMS, Rule 301 of Regulation ATS, and the CTA Plan and Nasdaq UTP Plan.

## **XI. Text of Proposed Amendments to the CTA Plan and Nasdaq UTP Plan**

### **A. The CTA Plan**

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<sup>213</sup> See supra notes 207-209 and accompanying text.

The Commission hereby proposes to amend the CTA Plan to amend the definition of trade report to provide for a unique identifier on each trade report of a trade effected by an Alternative Trading System.

Set forth below are the changes the Commission is proposing to the language of the CTA Plan. Additions are underlined and deletions are in brackets.

**I. Definitions.**

(m) “Last sale price information” means (i) the last sale prices reflecting completed transactions in Eligible Securities, (ii) the volume and other information related to those transactions, (iii) the identifier of the Participant furnishing the prices, (iv) the identifier of the Alternative Trading System furnishing the prices to FINRA, and [iv] (v) other related information.

**VI. Consolidated Tape.**

(f) **Market Identifiers.** Each such last sale price when made available by means of the high speed line shall be accompanied by the appropriate alphabetic symbol identifying the market of execution; provided, however, that all last sale prices collected by FINRA and reported to the Processor shall, when so made available by the Processor, be accompanied by a distinctive alphabetic symbol distinguishing such last sale prices from those reported by any exchange or other reporting party, and all last sale prices reported by brokers or dealers required to file a plan with the SEC pursuant to the Rule shall, when so made available by the Processor, be accompanied by a distinctive alphabetic symbol distinguishing such last sale prices from those reported by FINRA or any exchange.

All last sale prices collected by FINRA from Alternative Trading Systems that are subject to Regulation ATS shall be accompanied by a unique identifier identifying the Alternative

Trading System that executed the trade (“ATS Identifier”). All last sale prices collected by FINRA from Alternative Trading Systems that are subject to Regulation ATS shall, when reported to the Processor by FINRA and when made available by the Processor, be accompanied by a unique ATS Identifier, unless the last sale price is for a transaction with a market value of at least \$200,000.

### **VIII. Collection and Reporting of Last Sale Data.**

(a) **Responsibility of Exchange Participants.** The AMEX, BATS, the BSE, the CBOE, the CHX, the ISE, Nasdaq, the NSX, the NYSE, NYSE Arca and the PHLX will each collect and report to the Processor all last sale price information to be reported by it relating to transactions in Eligible Securities taking place on its floor. In addition, FINRA shall collect from its members all last sale price information to be included in the consolidated tape relating to transactions in Eligible Securities not taking place on the floor of an exchange and shall report all such last sale price information to the Processor in accordance with the provisions of Section VIII(b) hereof, unless the last sale price is collected by FINRA from an Alternative Trading System subject to Regulation ATS for a transaction with a market value of at least \$200,000, in which case FINRA shall not report an ATS Identifier as part of the last sale price. It will be the responsibility of each Participant and each other reporting party, as defined in Section III(d) hereof, to (i) report all last sale prices relating to transactions in Eligible Securities as promptly as possible, unless the last sale price is collected by FINRA from an Alternative Trading System subject to Regulation ATS for a transaction with a market value of at least \$200,000, in which case FINRA shall not report an ATS Identifier as part of the last sale price, (ii) establish and maintain collection and reporting procedures and facilities such as to assure that under normal conditions not less than 90% of such last sale prices will be reported within that period of time

(not in excess of one and one-half minutes) after the time of execution as may be determined by CTA from time to time in light of experience, and (iii) designate as “late” any last sale price not collected and reported in accordance with the above-referenced procedures or as to which the reporting party has knowledge that the time interval after the time of execution is significantly greater than the time period referred to above. CTA shall seek to reduce the time period for reporting last sale prices to the Processor as conditions warrant.

#### **B. The Nasdaq UTP Plan**

The Commission hereby proposes to amend the Nasdaq UTP Plan to amend the definition of trade report to provide for a unique identifier on each trade report of a trade effected by an Alternative Trading System.

Set forth below are the changes the Commission is proposing to the language of the Nasdaq UTP Plan. Additions are underlined and deletions are in brackets.

#### **III. Definitions**

U. “Transaction Reports” means reports required to be collected and made available pursuant to this Plan containing the stock symbol, price, and size of the transaction executed, the Market in which the transaction was executed, and related information, including a buy/sell/cross indicator and trade modifiers, reflecting completed transactions in Eligible Securities and, in the case of FINRA, the FINRA member that entered the report, if such member is an alternative trading system subject to Regulation ATS.

#### **VI. Functions of the Processor**

##### **C. Dissemination of Information**

##### **3. Transaction Reports**



The Processor shall disseminate on the UTP Trade Data Feed a data stream of all Transaction Reports in Eligible Securities received from Participants. Each transaction report shall be designated with a symbol identifying the Participant in whose Market the transaction took place, and in the case of FINRA, with the identity of the FINRA member reporting the transaction if such member is an alternative trading system subject to Regulation ATS, unless the last sale price is for a transaction with a market value of at least \$200,000.

### **VIII. Transmission of Information to Processor by Participants**

#### **B. Transaction Reports**

Each Participant shall, during the time it is open for trading, be responsible promptly to collect and transmit to the Processor Transaction Reports in Eligible Securities executed in its Market by means prescribed herein. With respect to orders sent by one Participant Market to another Participant Market for execution, each Participant shall adopt procedures governing the reporting of transactions in Eligible Securities specifying that the transaction will be reported by the Participant whose member sold the security. This provision shall apply only to transactions between Plan Participants.

Transaction Reports shall include:

1. identification of the Eligible Security, using the Nasdaq Symbol;
2. the number of shares in the transaction;
3. the price at which the shares were purchased or sold;
4. the buy/sell/cross indicator;
5. the Market of execution; [and,]
6. through appropriate codes and messages, late or out-of-sequence trades,

corrections and similar matters[.]; and,

7. in the case of FINRA, the identity of the FINRA member reporting the transaction if such member is an alternative trading system subject to Regulation ATS, unless the last sale price is for a transaction with a market value of at least \$200,000.

## **XII. Text of Proposed Rule Amendments**

### **List of Subjects in 17 CFR Part 242**

Brokers, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, the text of Title 17, Chapter II, of the Code of Federal Regulations is proposed to be amended as follows.

### **Part 242 -- REGULATIONS M, SHO, ATS, AC, AND NMS AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES**

1. The authority citation for Part 242 continues to read in part 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.

2. Revise § 242.301(b)(3)(i) and (ii) to read as follows:

§ 242.301 Requirements for alternative trading systems.

\* \* \* \* \*

(b) \* \* \*

(3) \* \* \*

(i) An alternative trading system shall comply with the requirements set forth in paragraph (b)(3)(ii) of this section, with respect to any NMS stock in which the alternative trading system:

(A) Displays subscriber orders to any person (other than alternative trading system employees); and

(B) During at least 4 of the preceding 6 calendar months, had an average daily trading volume of 0.25 percent or more of the aggregate average daily share volume for such NMS stock as reported by an effective transaction reporting plan.

(ii) Such alternative trading system shall provide to a national securities exchange or national securities association the prices and sizes of the orders (other than orders having a market value of at least \$200,000 that are displayed only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000) at the highest buy price and the lowest sell price for such NMS stock, displayed to more than one person (other than alternative trading system employees), for inclusion in the quotation data made available by the national securities exchange or national securities association to vendors pursuant to § 242.602.

\* \* \* \* \*

3. Section 242.600 is amended by revising paragraph (b)(8) to read as follows:

§242.600 NMS security designation and definitions.

\* \* \* \* \*

(b) \* \* \*

(8) Bid or offer means the bid price or the offer price communicated by a member of a national securities exchange or member of a national securities association to any broker or dealer, or to any customer, at which it is willing to buy or sell one or more round lots of an NMS

security, as either principal or agent, but shall not include indications of interest that are not actionable and indications of interest for a quantity of NMS stock having a market value of at least \$200,000 that are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000.

\* \* \* \* \*

By the Commission.

Elizabeth M. Murphy  
Secretary

Dated: November 13, 2009