

FINANCIAL INFORMATION FORUM

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January 30, 2019

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Assistant Director
Division of Trading and Markets
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

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

Dear Ted,

On behalf of the members of the Financial Information Forum’s (“FIF”)¹ SEC Rule 606 Working Group (“Working Group”), this letter is respectfully submitted in preparation for our meeting with you and Trading & Markets Staff next week. This letter (including Appendix A) raises several identified challenges which require further guidance from the Commission (“SEC” or “Commission”).

Introduction

Amended Rule 606(b) requires Broker-Dealers (“BDs”) to generate on-demand customer reports, which includes a standardized set of individualized disclosures.² To acquire this information, Introducing Brokers (“IBs”) in some scenarios are required to obtain look-through data from orders routed to downstream Executing Brokers (“EBs”). Obtaining 606(b) data requires the extensive tracking of orders from placement to execution (and subsequently passed back to the IB from the EB). Today, several IBs are not provided all the necessary downstream order execution data from the EB in a format that is easily transferrable to 606(b) reports. To derive all required 606(b) information³ from orders executed by EBs, several firms will be required to undergo significant operational, business and technological changes that may not be possible to complete prior to the May 20, 2019 Compliance Date.

Furthermore, FIF Working Group members have identified several other challenges/questions in addition to the Amended Rule’s requirements that IBs obtain and report downstream order execution data. Additional challenges include:

¹ FIF (www.fif.com) was formed in 1996 to provide a centralized source of information on the implementation issues that impact the securities industry across the order lifecycle. Our participants include trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

² <https://www.sec.gov/news/press-release/2018-253>

³ For example, the Amended Rule requires that IBs obtain from EBs downstream information of executed orders which includes but is not limited to: 1) fee and rebate information; 2) reporting obligations stemming from an IBs use of an EB’s Smart Order Router or Algorithm; 3) information pertaining to the taking/making of liquidity; and 4) the treatment of Riskless Principal Orders.

1. Options reporting under Amended Rule 606(a);
2. Complex Options and Option Valuation;
3. Actionable IOIs;
4. Precision around reporting NBBO; and
5. Questions related to specific fields, including Total Shares Routed that were Further Routable.

Appendix A includes more granular detail regarding the need for additional guidance with respect to the above-mentioned challenges. However, FIF believes many of the Amended Rule's implementation challenges may be reduced should the Commission clearly delineate the scope of when 606(b) reporting obligations are triggered.

Definitional Ambiguity – Discretion

FIF believes that the genesis of the industry's uncertainty regarding Amended Rule 606(b)'s reporting obligations stems from the perceived ambiguity regarding the definition of BD discretion. Working Group members carefully reviewed guidance outlined in the Adopting Release⁴ concerning "discretionary"⁵ routing decisions of an IB and/or an EB. However, widespread confusion remains regarding when reporting obligations are triggered under Amended Rule 606(b) (*i.e.* when a BD is deemed to have exercised discretion). Therefore, the industry requires definitive guidance that goes beyond what is provided in the Adopting Release.

Much of the perceived ambiguity regarding the definition of discretion stems from the examples set forth in the Adopting Release.⁶ For example, the Commission notes that "[if] the BD simply forwards its customers' orders on to another BD and that second BD exercises all discretion in determining where and how to route and execute the orders, then the first BD is not required to provide disclosures under Rule 606(b)(3)."⁷ Industry members currently are unclear if this example of a non-discretionary order routing decision applies to cases in which the BD, for example, simply routed an order to another BD's Smart Order Router ("SOR") or Algorithm ("Algo") with an instruction of 'aggressive' without any further instruction as to the ultimate destination.

The Commission notes several additional scenarios that specify when an IB is deemed to have exercised discretion with regard to how an order is routed and ultimately executed, including: "1) determining particular venue destinations of an order; 2) choosing among different trading algorithms; 3) adjusting or customizing algorithm parameters; and/or 4) performing other similar tasks involving using its own judgement as to how and where to route and execute orders."⁸ FIF believes that in several common business scenarios, the parameters set forth in the Adopting Release do not, in practice, necessarily indicate that a BD is exercising discretion in determining the destination of an order.

⁴ SEC Release No. 34-84528 (November 2, 2018).

⁵ *Id.* at 71.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

For example, it is very common for an IB to route a not held “parent” order to an EB and specify that the order should be a VWAP with certain parameters, including: 1) level of aggressiveness; 2) duration of order; 3) limits on percentage of volume; 4) and preferred sets of venues the EB should use. In this very common example, the IB typically has no actual control or knowledge of how (or how many) child orders the EB may generate and/or route to other venues as it seeks to fill the IB parent order consistent with the IB’s VWAP instructions. However, current guidance suggests that simply because the IB customized the VWAP parameters of the parent order, the IB has therefore “exercised discretion.”⁹ This triggering event would then require the reporting on 606(b) reports all child orders that were subsequently created and routed by the EB of which the IB has no knowledge.

The example set forth above illustrates one of several common use cases in which industry members are require clarity regarding whether the Commission intended that the IB has in fact exercised discretion, and accordingly would be required provide execution detail on 606(b) reports. As such, the industry requests clear and unambiguous guidance from the Commission regarding BD discretion.

IB Access to Downstream Order Routing Data

Depending upon the guidance issued by the Commission concerning when a BD’s Rule 606(b) obligations are triggered, firms may be required to provide all downstream look-through information pertaining to the requirements outlined in Amended Rule 606(b)(3)(i-iv). Therefore, many firms will be required to undergo significant business process and systems changes prior to the Compliance Date. Changes include but are not limited to:

1. Mapping of all the flows a BD’s Orders could possibly take after an order leaves a BD’s system(s);
2. Collecting and reporting fee and rebate information from all downstream EBs;
3. Developing a method of reconstructing the relevant trades to which specific fees/rebates should be applied;¹⁰ and
4. Normalizing client-specific data where omnibus average price accounts are utilized.¹¹

FIF strongly emphasizes that these required systems and business process changes will not be possible for many firms given the four (4) months remaining for implementation.

Conclusion

FIF wishes to thank the Commission for the opportunity to provide feedback on Amended Rule 606. The issues FIF members have highlighted in this comment letter, including answers (*i.e.* “FAQs”) to the substantive questions raised in Appendix A, are of critical concern to the industry. We look forward to discussing these important topics with Trading & Markets Staff on Tuesday, February 5, 2019.

⁹ *Id.*

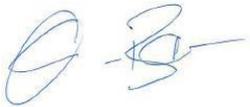
¹⁰ For example, specific executions from an operations perspective would be required to be linked to specific client orders. This would require another significant build-out. Similar process and systems modifications are being developed for the Consolidated Audit Trail (“CAT”) which requires the reporting of this information.

¹¹ These challenges are a subset of the identified challenges identified during the Working Group’s review of Amended Rule 606. FIF will further explain the challenges of deriving and reporting downstream 606(b) data during the in-person meeting with the Commission scheduled for February 5, 2019.

Respectfully,

A handwritten signature in blue ink that reads "Son-Mi Lee".

Son-Mi Lee, Esq.

A handwritten signature in blue ink that reads "Christopher Bok".

Christopher Bok, Esq.

CC: John Roeser, Associate Director, Division of Trading and Markets, SEC
David Shillman, Associate Director, Division of Trading and Markets, SEC

Appendix A – FIF Requests for Guidance (FAQs)

1. Definition of Venue –

- a. Footnote 63 of the November 17, 2000 Adopting Release to SEC Rule 11Ac1-6¹² provides a definition of “venue.” Should this same definition be applied to Amended Rule 606? Footnote 63 states as follows:

The term "venue" is intended to be interpreted broadly to cover "market centers" within the meaning of Rule 11Ac1-5(a)(14), as well as any other person or entity to which a broker routes non-directed orders for execution. Consequently, the term excludes an entity that is used merely as a vehicle to route an order to a venue selected by the broker-dealer. Interpretive issues may arise in determining the applicability of the Rule when a person or entity trades under the auspices of an exchange. To assure meaningful disclosure of significant execution venues, all orders routed to a particular exchange for execution should be aggregated when calculating a broker-dealer's top ten market centers and those with 5% of orders. If a particular market maker or dealer at the exchange receives orders pursuant to any arrangement that gives it a preference to trade with the order as principal, such arrangement must be specifically included in the discussion of the relationship between broker-dealer and venue that is required by Rule 11Ac1-6(b)(1)(iii).

- b. In situations where internalized orders are executed by the EB, should the EB be interpreted as the venue receiving the order?

2. Options

- a. Complex Options:
 - i. Specific to held orders subject to Amended Rule 606(a)(1), more clarity is required regarding how firms are expected to calculate marketable/non-marketable limit for complex options orders since the concept of NBBO does not currently apply to options. Are firms expected to calculate the NBBO based upon a synthetic NBBO derived from available market data?
- b. FIF recommends that due to lack of clarity around the concept of marketable/non-marketable limit orders as applied to options, Complex Options should be included in an “other” bucket. Further, if a BD accepts option exchange linkage orders, is it exempt from Amended Rule 606 reporting?
- c. How does the SEC expect the notional value to be calculated for options?
 - i. FIF recommends that the Commission consider using the same logic that is applied to Large Trader for the calculation of notional value for options.
- d. Should the value for options be calculated based on the parent or child order of an order?
- e. For buy-write or multi-leg orders that have an option and equity leg component, would each leg be included in its own bucket for Amended Rule 606(a) reporting

¹² *Supra* note, 4.

(i.e. stock leg calculated as an S&P 500 NMS stock and the option leg as an option order based on the assumption that the notional value of the order is less than \$50,000)? Alternatively, would multi-leg orders and buy-writes be included as part of option statistics or are they excluded from Amended Rule 606 reporting?

- f. Are options to be reported by market maker or exchange? (The published schema only has exchanges as examples).
 - i. For firms that do not route directly to exchanges, but by consolidator, are the net payment columns to be populated by *consolidator* rebates? (This would prove challenging as rebates from consolidators are not broken out by exchange).
 - ii. FIF would like to confirm that the option schema examples for net payments should be established on a per contract basis? (The schema shows options as per hundred shares).

3. Riskless Principal Transactions and Aggregated Orders

- a. In cases in which orders are received by a BD and executed riskless principally, should those executions be reported as executed for a firm's own account? Pursuant to the Rule, the total number of shares executed as principal must be reported upon request. Should shares executed as riskless principal be included or excluded? Under existing guidance, BDs are currently required to treat orders handled on a riskless principal basis as though it were an agency order (*see* Rule 11Ac-1 [FAQ11](#)).
- b. How specifically are firms expected to handle aggregated orders for the purpose of Amended Rule 606 Reporting?
- c. The following is an example of riskless principal trading, which is particularly aggravated by situations where an EB utilizes average price accounts which can make deriving Related Data and categorizing such data challenging. For firms with the ability to provide Related Data sooner, rather than later, due to processes established prior to the adoption of the Amended Rule, questions regarding the treatment of Riskless Principal orders still remains:
 - 1) BD1 Receives Not Held Order to Purchase 100,000 shares of ABC and enters it into an OMS which places all orders in the OMS into an average price account and routes to BD2 for execution;
 - 2) BD2 creates four 25,000 share principal orders of ABC in an EMS and routes to ten different exchanges and ATSS over period of two hours and receives back 1,000 executions totaling 100,000 shares at an average price of \$17.775;
 - 3) BD2 fills the Not Held order with capacity of Riskless Principal with quantity of 100,000 shares and price of \$17.775;
 - 4) BD1 will receive a fill from BD2 for the order that it sent in step 1.

In the aforementioned use case, significant development work must be completed before BD1 could begin to provide downstream order data where average price accounts are utilized. Clarity is required as to whether BD2 should provide BD1 with actual fees/rebates or fees/rebates, including embedding a markdown/markup for

the charge of EB's execution. Furthermore, for average price accounts, BD1 and BD2 would be required to determine how to desegregate BD1's client-by-client orders. Then, as fee/rebate data is not available until month-end and as executions and allocations are not currently linked for average price accounts, BD2 would be required to develop a method of tracing and reconstructing all of its executions to pro-rate aggregated fees once they are received to specific trades and orders.

4. Actionable IOIs

- a. FIF seeks clarity from the Commission on the definition of Actionable IOIs under Amended Rule 606. Is an Actionable IOI one which is tantamount to a quote as in proposed Rule 600(b)(8), which was largely aimed at dark pools in the [Regulation of Non-Public Trading Interest Proposing Release](#)¹³ ("NPTI Proposing Release")?
 - i. From an implementation standpoint, it seems that only firms with large trading platforms such as ATs, dark pools, block crossing networks, etc. which may possibly utilize Actionable IOIs in such a manner would possess such information.

5. Total Shares Routed that were further Routable

Greater clarity is required from the Commission regarding the reporting of Total Shares Routed that were further routable given the operational complexities.

- a. Pursuant to Amended Rule 606(b)(3), the on-demand customer reports require firms to disclose the total number of shares routed that were further routable. FIF believes categorizing routes as 'further routable' will require complex, creative, and difficult to maintain business logic and the use of non-normalized destination specific attributes, which are not readily available in data warehouses that drive current Rule 606 reporting.
 - i. Some venues may never route, and therefore, firms must understand which venues do not route and suppress all routes for those venues. Those venues that do not route would be required to be identified and categorized at the venue level.
 - ii. Some venues may route out unless there are explicit instructions - "Do Not Route." This is a handling instruction on routes not reportable today. This information will be reportable in the CAT, but CAT build outs are underway currently and are not available given the aggressive Rule 606 implementation timeframe.
- b. Firms require additional clarity on which metrics should be used to determine whether an order is further routable. Are firms required to evaluate all order types to make that determination or may a best efforts standard be applied?
 - i. Even if available, decoding destination specific attributes and correlating them with a further routable categorization based on destination specific logic will be error prone and not practical to maintain.

6. NBBO

- a. Firms require more clarity on how precise the NBBO at the time of execution should be. May firms capture the NBBO at the same time as they capture the execution (sent to BDs/Service Bureaus) from exchanges or third parties)? In many instances,

¹³ *Id.*

the NBBO may change between the time of the execution to when a firm receives the execution message.

7. Removing/Providing Liquidity

- a. 606(b) reports require that for orders adding liquidity but were subsequently cancelled, BDs must report information regarding the time between entry and cancellation. In order to properly report this information, firms require a better understanding of how order cancellations should be treated. Is liquidity information required to be reported if an order does not result in any executions?
- b. For venues that perform a midpoint crossing, where both parties are matched by the venue, how should they be treated from a liquidity standpoint for the purpose of 606? The FIX Community in particular has focused on this question in implementing technological changes to relevant systems.

8. Fees & Rebates on Orders Executed by SOR of Another BD

- a. FIF requests clarification regarding the scope of reporting obligations (*i.e.* whether the IB has exercised discretion, thereby triggering 606(b) reporting obligations). If BD1 has discretion over how an order is routed and executed through a SOR/Algo housed at BD2, is BD1 required to provide the look-through information on how the order was treated on BD1's customer-specific report (*i.e.* information pertaining to fees/rebates through the SOR/Algo)?
 - i. For example, if BD1 routes a Not-Held VWAP to BD2 and specifies as "aggressive," is that sufficient discretion to trigger the look-through, or does the SEC consider that to be more of a pass-through of the order (and therefore look-through is not required)?
- b. In the following scenario, BD1 receives Not Held flow from Customer1. BD1 then routes the order to BD2 that provides a 3rd party SOR/Algo routing platform. BD1 uses BD2's MPID to access the market. What is BD1's reporting obligation to its clients under Amended Rule 606 with respect to net fees/rebates and taking/providing liquidity?
- c. Further clarification is requested regarding the expectations pertaining to fees and rebates passed from a SOR to the IB. For example, a BD may be paying fees specific to the operator of the SOR. In this case, looking-through would require access to exchange fees and rebates, which only the BD that provides would know unless the BD providing the SOR provides that information.
 - i. Today, many BDs may not manage fees schedules all the way to down to the share/execution level.
- d. Firms require clarification for instances of when a fee does not get passed through, such a transaction fee. How should introducing firms handle such a situation?
- e. What is the definition of a transaction fee paid for options (*i.e.* auction fees? Origin code/priority fees?) Are CBOE SPX license fees included?
- f. How will fee schedules be disclosed under material aspects for exchanges? Would a link to an exchange fee schedule be sufficient?

9. Marketability vs. Non-Marketability

- a. Are Not-Held orders where the price is contingent on a relationship included in the scope of 606(b)(3)? (*i.e.* two or more orders involving at least one leg as NMS stock such as with convertible securities, options or arbitrage spread trades).
- b. How is marketability determined on pre and post-session equity orders?
- c. For options, will the same rule apply for options as equities when separating routing information for marketable and non-marketable limit orders? (*i.e.* the entire order would be included in a marketable limit bucket irrespective of the availability of liquidity or subsequent price movement).

10. Amended Rule 606(a) Reporting Expectations

- a. What is the deadline/expectation to have the Amended Rule 606(a) data processed with the SEC and available on the Firm's website (FIF assumes 30 business days after the previous month)?

11. Specification Related Questions

- a. **Fields w/ Positive or Negative Number**
 - i. For fields that are designed to reflect either a positive or negative number, such as "netPmtPaidRecvMarketOrdersUsd," what is the sign convention? Does positive mean a firm paid a fee and does negative mean a firm received a rebate, or vice versa?
- b. **PDF Renderer**
 - i. The PDF renderer should include definitions displayed in the text so that a reader of the PDF report will know whether a positive number is 'paid' or 'received'.
 - ii. The PDF renderer should insert page breaks between the sections to make it much more readable.
- c. **XML Tag for Comment Field**
 - i. We suggest adding a free-text XML tag for BDs to be able to enter any additional comments or information they feel is needed to accurately represent the information. For example, if a venue was added within the last week of the month, a BD may want to state that in the report so users know the values are smaller than should be expected in subsequent filings.