

FINANCIAL INFORMATION FORUM

11 Hanover Square
New York, NY 10005

June 24, 2021

By electronic mail

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attn: Mr. David Saltiel, Acting Director, Division of Trading and Markets

Re: Request for Written Guidance Relating to SEC Rule 606

Dear Mr. Saltiel,

The Financial Information Forum (FIF)¹ submits this letter on behalf of FIF member firms to request additional written guidance from the staff of the Securities and Exchange Commission (the Commission) relating to Rule 606 of the Commission's Regulation NMS.²

On November 2, 2018, the Commission adopted amendments to Rule 606 of Regulation NMS (the Rule 606 Amendments).³ The Commission staff subsequently issued Responses to Frequently Asked Questions (FAQs) to assist industry members in interpreting the Rule 606 Amendments.⁴ FIF members are very appreciative of the Rule FAQs that the Commission staff have issued to date. These FAQs are very detailed and involved significant work by Commission staff on an expedited basis, and FIF members rely on these FAQs in interpreting the Rule 606 reporting requirements.

FIF members continue to identify interpretive questions relating to Rule 606, including the questions raised in this letter. It is important that the Commission staff continue to update these FAQs on an ongoing basis as issues are identified and raised. This is to ensure that all industry members have access to the same interpretive guidance and to avoid misunderstandings relating to guidance that is provided.

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 17 C.F.R. §242.606.

³ See "Disclosure of Order Handling Information", File No. S7-14-16 (November 2, 2018), 83 FR 58338 (November 19, 2018).

⁴ "Responses to Frequently Asked Questions Concerning Rule 606 of Regulation NMS", available at <https://www.sec.gov/tm/faq-rule-606-regulation-nms> (Rule 606 FAQs).

In this letter, FIF identifies the following four scenarios where FIF members request additional written interpretive guidance:

- Look-through for options
- Customer orders sent directly to an ATS
- Broker-dealer operator of an ATS executing as counter-party
- Rule 606 reports requested by underlying clients.

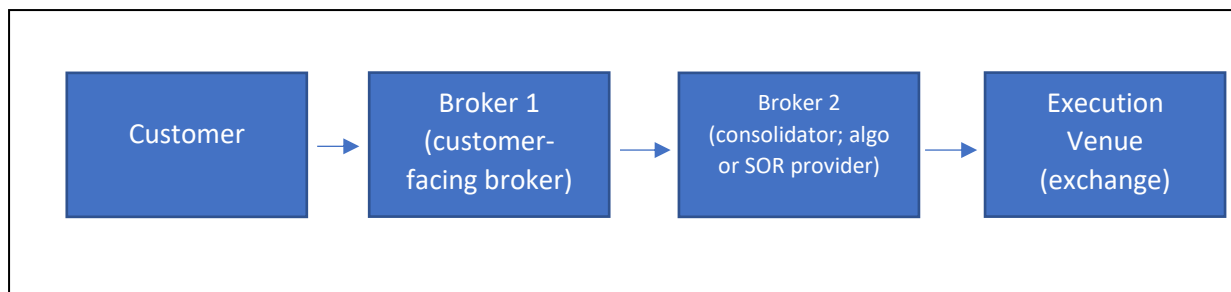
We discuss each of these scenarios in detail in this letter.

I. Look-through for options

The Commission staff have issued a series of FAQs relating to the look-through requirements for reporting under Rule 606. To date, the Commission has required look-through for the equities portion of 606(a)(1), which covers primarily retail customer orders, as the scope of the report is limited to “held” flow. As discussed in Appendix 1, this look-through applies only where “the broker-dealer to which the orders were routed does not execute orders.”⁵ The Commission has also required look-through for the not-held 606(b)(3) customer on-demand report where the broker exercises “discretion.” (We further review the equities look-through requirements in Appendix 1 below.)

However, during recent regulatory audits by FINRA, FINRA auditors have advised industry members that look-through is required for options routing through an algo or SOR provider even where the customer-facing broker has no knowledge of, or input into, where the algo or SOR provider routes orders. FINRA representatives have stated that their advice is based on verbal guidance that they have received from Commission staff.

The following is a diagram of a sample options order handling workflow:



For this scenario, FAQ 13.01 issued by the Commission provides the following guidance:

“If a retail options broker routes all of its customer options orders to one or more consolidators, and the consolidator in fact makes the routing decisions concerning those customer orders, including to exchanges where the consolidator or its affiliate acts a

⁵ Rule 606 FAQs, FAQ 12.01.

liquidity provider to those orders, the consolidator could be effectively acting as the venue for execution for purposes of the rule. Given the market structure for listed options that are NMS securities, where orders for such options must be executed on an exchange, the consolidator will route to exchanges the customer options orders received from retail brokers. To comply with the rule, therefore, a retail options broker could disclose each of its consolidator relationships and, for each such relationship, provide the applicable information required by Rule 606(a)(1).”

A number of FIF members have interpreted FAQ 13.01 based on its plain meaning, which is that an algo or SOR provider is the venue for execution (and no look-through is required) if the algo or SOR provider “makes the routing decisions concerning those customer orders”. This is particularly true where the algo or SOR provider can act as a liquidity provider or has an affiliate that can act as a liquidity provider. FIF members are concerned that the regulators are providing guidance that either is inconsistent with FAQ 13.01 or, at a minimum, not clearly stated in FAQ 13.01.

FIF members recommend that the Commission staff provide written clarification that look-through is not required for options orders when a consolidator makes the routing decisions concerning a customer order, consistent with the current wording of FAQ 13.01. As discussed in more detail below, the look-through requirement takes the focus away from the route over which a customer-facing broker has actual discretion: i.e., the route to the consolidator. In addition, firms have implemented their Rule 606(a) reporting for options based on FAQ 13.01.

Alternatively, if the Commission determines that look-through should be applied to options orders, FIF members recommend that the Commission staff provide a written update to FAQ 13.01 (or issue a new FAQ) to make clear the conditions for when look-through is required for options. FIF members further recommend that they be afforded a reasonable time period from when the updated FAQ is issued to implement the business and technical changes required to comply with the updated FAQ. These business and technical changes include obtaining and processing additional routing information from downstream service providers.

Additionally, FIF members request that the Commission further clarify how the look-through requirements for options align with the guidance in FAQs related to equities look-through requirements. For your reference, FIF reviews our understanding of the look-through reporting obligations for retail and institutional customer orders for equities in Appendix 1 below.

Against the backdrop of the existing look-through requirements for equities, FIF members further request the following clarifications relating to FAQ 13.01 as well as relating to overall look-through for options:

- Why does FAQ 13.01 (relating to options) reference affiliates of the consolidator, while the FAQs relating to equities do not reference affiliates of the routing broker?
- Why does FAQ 12.01 consider whether a broker “executes orders” in general, while FAQ 13.01 references whether the consolidator or its affiliate “acts as a liquidity provider to those orders”?

- Is there a difference in the look-through requirement for options based on whether the consolidator can trade as principal?
- Is there a difference in the look-through requirement for options based on whether the consolidator has an arrangement with another firm that acts as principal?
- Is there a difference in the look-through requirement for options based on whether a firm uses a third-party smart order router vs. a third-party algo?
- Why does FAQ 13.01 reference a retail options broker when Rule 606(a) applies to held and not held options orders?
- Is there a difference in the look-through requirement for options based on whether an order is a held or not held order?
- At the time of routing, a firm does not necessarily know whether the consolidator or an affiliate will be the counter-party for the applicable order. How does this impact the requirement for look-through reporting?
- What happens if the executing broker routes to an exchange where the routing firm is “not a member”? Would the look-through on the Rule 606(a) options report mislead the originating customer when reviewing the Rule 606 report?

FIF would like to also highlight that FIF members continue to have ongoing concerns with the look-through requirements set forth in the Rule 606 FAQs. FIF members believe that the Rule 606 reports would be far more beneficial to retail and institutional investors without these look-through requirements. The spirit of Rule 606 is to provide transparency into potential routing conflicts between the reporting broker and its top venues. The look-through requirement takes the focus away from the route over which a customer-facing broker has actual discretion: i.e., the route to an executing broker. The relationship between a customer-facing, or introducing broker and an executing, or routing broker is obscured by look-through, which places a greater emphasis on downstream routes to execution venues.

FIF members also note that their ability to oversee the execution venue fees reported to them by a routing broker is limited because an introducing broker is not a party to the economic arrangements between a routing broker and an execution venue. FIF members would appreciate the opportunity to discuss the general issue of look-through with Commission staff at a future date as part of a longer-term discussion.

II. Customer orders sent directly to an ATS

FIF members request guidance on how to report under Rule 606(b)(3) in the scenario where a customer routes orders directly to an ATS. In this scenario, a customer that is not a broker-dealer and is a subscriber to an ATS transmits orders directly to the ATS. Are these orders reportable under Rule 606(b)(3)? Is the broker-dealer operating the ATS expected to include these orders in its Rule 606(b)(3) report? If so, should these orders be classified as directed orders? Alternatively, is the ATS expected to provide its own Rule 606(b)(3) report to the customer for these orders instead of including these orders on the broker-dealer’s Rule 606(b)(3) report?

III. Broker-dealer operator of an ATS executing as counter-party

FIF members request guidance on how to report under Rule 606(b)(3) when a broker-dealer that operates an ATS is the counter-party to a customer order executed in the ATS. Should the broker-dealer report a principal execution for this order? Should the ATS separately be reported as an execution venue for the same order?

IV. Rule 606 reports requested by underlying clients

The proposing⁶ and adopting⁷ releases for Rule 606 make clear that a broker-dealer is not required to provide Rule 606 reports to the underlying clients of a third-party manager that is the broker-dealer's customer.

The Commission provides as follows in the adopting release:

The Commission proposed in Rule 606(b)(3) that every broker-dealer shall, on request of a customer that places, directly or indirectly, an institutional order with the broker-dealer, disclose to such customer a report on its handling of institutional orders for that customer. The Commission noted in the Proposal that, pursuant to this rule language, a broker-dealer would be required to provide the order handling report to the customer placing the institutional order with the broker-dealer, even if the customer is acting on behalf of others and is not the ultimate beneficiary of any resulting transactions. Thus, the broker-dealer would not be required to provide the order handling report to the underlying clients of that customer.⁸

The Commission further provides in the adopting release:

The Commission continues to believe that requiring the reports to be provided to the customer that places the order with the broker-dealer – whether the customer is the account holder or an investment adviser or other fiduciary – is appropriate because it would require the broker-dealer to provide detailed information to the person that is responsible for making the routing and execution decisions for such order and for assuring the effectiveness of those functions.⁹

Some broker-dealers that are FIF members have received requests for Rule 606 reports from the underlying clients of a third-party manager. FIF members would appreciate if the Commission could clarify in an FAQ the guidance from the proposing and adopting releases that a broker-dealer is not required to provide an order handling report to the underlying clients of a third-party manager.

* * * * *

⁶ Securities Exchange Act Release No. 78309, 81 FR 49432 (July 27, 2016).

⁷ Securities Exchange Act Release No. 84528, 83 FR 58338 (November 19, 2018) (“Adopting Release”).

⁸ Adopting Release at 58355.

⁹ Adopting Release at 58356.

FIF and our members appreciate the staff's consideration of the above requests and would appreciate the opportunity to discuss these issues in more detail. It would be beneficial for regulatory personnel and for industry members if industry members have clear guidance relating to the scenarios described above. For any matters discussed in this letter, please contact me at howard.meyerson@fif.com.

Very truly yours,

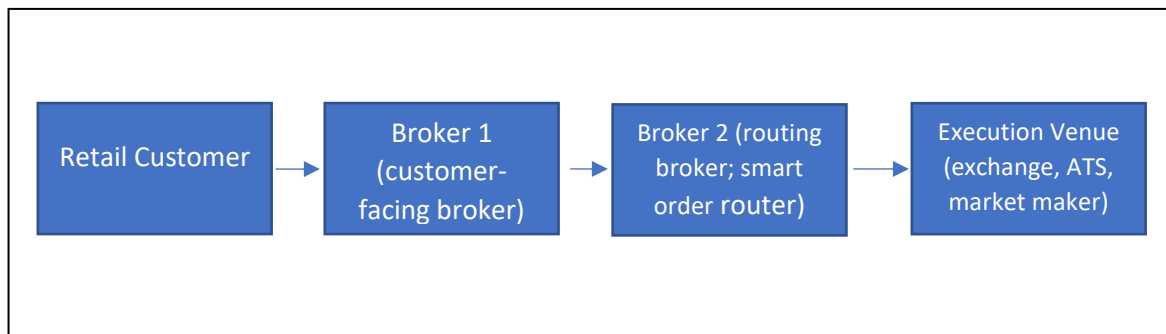
/s/ Howard Meyerson

Howard Meyerson, Managing Director, Financial Information Forum

cc: Mr. Michael Bradley
Mr. John Roeser
Mr. Theodore S. Venuti

Appendix 1
Summary of look-through requirements for Rule 606 reporting for equity orders

Retail customer orders (equities) – 606(a)(1) quarterly reporting look-through¹⁰



According to Rule 606 FAQ 12.01 published by the Commission, look-through applies where Broker 2 does not execute orders:

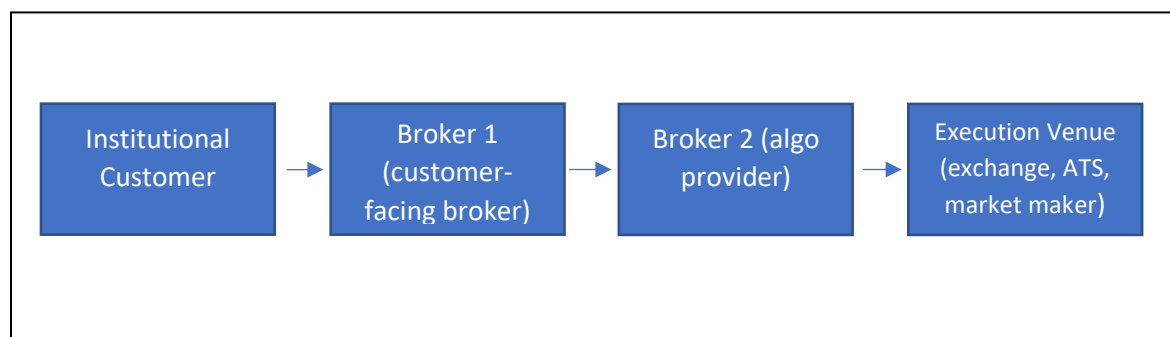
“If, however, the broker-dealer to which the orders were routed does not execute orders, as is posited by the question here with respect to Broker-Dealer B, that broker-dealer would not be a venue to which orders were routed for execution. Rather, the venues to which Broker-Dealer B routes child orders for execution would be the relevant venues for Rule 606(a)(1) reporting purposes.”¹¹

If look-through applies, Broker 1, in its Rule 606(a) report, would show a route to the Execution Venue and not a route to Broker 2. In the row for reporting the fees paid to or received from the Execution Venue, Broker 1 would report the fees paid to the Execution Venue by Broker 2 or the rebates received by Broker 2 from the Execution Venue.

¹⁰ The Rule 606(a) report for equities applies to “held” orders; the Rule 606(b)(3) report for equities applies to “not held” orders. For purposes of simplification, we assume that retail orders for equities are held orders subject to reporting under Rule 606(a) and that institutional orders for equities are not held orders subject to reporting under Rule 606(b)(3). For options, held and not held orders are both subject to reporting under Rule 606(a).

¹¹ Rule 606 FAQs.

Institutional customer orders (equities) – 606(b)(3) on-demand look through



According to Section 1, Issue 1, of the Rule 606 FAQs, look-through applies in the scenario above where Broker 1 exercises discretion over how an order is routed, described as follows:

“A broker-dealer exercises discretion over how an order is routed and ultimately executed through its decision making and its participation in choices related to the use and configuration of algorithms, smart order routers, and other trading strategies (collectively, “execution services”). For example, with respect to the use of another broker-dealer’s smart order routers, a broker-dealer exercises discretion when a broker-dealer using another broker’s execution services, at any point prior to the routing of an order, participates in venue selection and prioritization for an order (including exclusions) and/or chooses among different pre-set routing configurations that affect routing decisions. As another example, a broker-dealer exercises discretion if it negotiates economic terms for execution services that, depending upon differential pricing and/or other terms of the arrangement, have a material effect on the routing choices being made. And, a broker-dealer exercises discretion at the time an order routing decision is made if it selects from among multiple order routing strategies provided by another broker that engage market liquidity in meaningfully different ways, *e.g.*, actively vs. passively.”¹²

In the scenario above, Broker 1 might incur two types of fees. The first type of fee is a pass-through fee; this is a fee that the execution venue charges to Broker 2 and Broker 2 passes-through to Broker 1. This can also be a rebate, but we refer to this as a fee for purposes of simplification. The second type of fee is the add-on fee; this is a service fee that Broker 2 charges to Broker 1 that is in addition to any pass-through fee.

If look-through applies in the scenario above, Broker 1, in its Rule 606(b)(3) report, would show separate routes to Broker 2 and to the Execution Venue.¹³ The route to Broker 2 is reported as PRV (Primary Routing Venue) and no execution data is reported for this row. Instead, the add-on fee that Broker 2

¹² Rule 606 FAQs.

¹³ For purposes of simplification, we assume that retail orders for equities are “held” orders subject to reporting under Rule 606(a) and that institutional orders for equities are “not held” orders subject to reporting under Rule 606(b)(3). For options, held and not held orders are both subject to reporting under Rule 606(a).

charges to Broker 1 is reported. The report also shows a route to the Execution Venue. The row for the Execution Venue is reported as EV/SRV (Execution Venue/Secondary Routing Venue) and includes execution data (for example, whether the execution was at the mid-point, better than the mid-point or worse than the mid-point). This row also includes any fees charged by the Execution Venue to Broker 2 (net of any rebates), whether or not Broker 2 passes those fees through to Broker 1.