

FINANCIAL INFORMATION FORUM

December 20, 2022

By electronic mail to rule-comments@sec.gov

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attn: Secretary

Re: File Number SR-FINRA-2022-031: Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Adopt FINRA Rules 6151 (Disclosure of Order Routing Information for NMS Securities) and 6470 (Disclosure of Order Routing Information for OTC Equity Securities)

Dear Secretary,

The Financial Information Forum (“FIF”)¹ appreciates the opportunity to comment on SR-FINRA-2022-031 filed by the Financial Industry Regulatory Authority (“FINRA”) with the Securities and Exchange Commission (the “Commission”)² and the Commission’s associated Notice of Filing (the “Notice of Filing”).³ The filing by FINRA (the “FINRA Rule Filing” or the “Rule Filing”) proposes to adopt FINRA Rule 6470 (Disclosure of Order Routing Information for OTC Equity Securities) to require FINRA member firms to publish order routing reports for orders in OTC Equity Securities (as defined in the Rule Filing) and submit their order routing reports for OTC Equity Securities for publication on the FINRA website. The Rule Filing also proposes to adopt FINRA Rule 6151 to require members to submit their order routing reports for NMS Securities (as defined in the Rule Filing) for publication on the FINRA website.⁴

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 broker-dealers, exchanges, back office service bureaus, and market data, regulatory reporting and other technology vendors in the securities industry. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

² Financial Industry Regulatory Authority, “Proposed Rule Change to Adopt FINRA Rules 6151 (Disclosure of Order Routing Information for NMS Securities) and 6470 (Disclosure of Order Routing Information for OTC Equity Securities),” SR-FINRA-2022-031 (Nov. 16, 2022), available at <https://www.finra.org/sites/default/files/2022-05/SR-FINRA-2022-013.pdf>.

³ Securities Exchange Act Release No. 96415 (Nov. 30, 2022), 87 FR 74762 (Dec. 6, 2022) (“Notice of Filing”).

⁴ Notice of Filing, at 74762.

I. Look-through

Look-through is not included in the text of Rule 606(a) and was not discussed in the adopting release for the 2018 amendments to Rule 606(a)

FIF members oppose the Rule Filing because it adopts the highly problematic “look-through” approach that the Commission has mandated for reporting under Rule 606(a) of the Commission’s Regulation NMS.⁵ The Commission mandated look-through for Rule 606(a) reporting subsequent to the Commission’s adoption of amendments to Rule 606 in 2018 (the “2018 Amendments”). Look-through is not included in the text of Rule 606(a), nor is look-through discussed in the adopting release for the 2018 Amendments (the “2018 Adopting Release”) in relation to Rule 606(a) reporting.⁶ Rather than including look-through in Rule 606(a) or the 2018 Adopting Release in relation to Rule 606(a), the Commission has implemented look-through via FAQs, verbal discussions with industry members, Commission and FINRA audits and, most recently, a Risk Alert from the Commission’s Division of Examinations.⁷

Specifically, there is a common scenario that the Commission did not contemplate when it adopted the 2018 Amendments in relation to Rule 606(a). This is a scenario where a firm (the “reporting firm”) receives and routes a customer order to a second firm, and the second firm (the “routing firm”) can route the order to various execution venues but cannot itself execute the order (either as principal or through an agency cross). We refer to this as the “routing firm” scenario. Subsequent to the adoption of the 2018 Amendments, the Commission has provided guidance that look-through should be applied for the routing firm scenario when reporting under Rule 606(a). With look-through, a broker-dealer must report in the Rule 606(a) tables (and also in the material aspects disclosures) the net fees paid or received between the routing firm and the venue, and the broker-dealer does not report in the Rule 606(a) tables the net fees paid or received between the reporting broker-dealer and the routing firm. We discuss below why this look-through reporting obscures relevant information from retail investors and leads to inconsistent reporting across firms.

Rule 606(a) requires a broker-dealer to report the “... venues to which ... orders ... were routed for execution....”⁸ Rule 606(a) then requires “... a discussion of the material aspects of the broker’s or dealer’s relationship with each venue identified, including a description of any arrangement for payment for order flow and any profit-sharing relationship”⁹ The problem is that the reporting broker-dealer does not have a relationship with the venue in connection with the routing firm scenario, nor does it have any arrangement for payment for order flow or profit-sharing relationship with the venue. Rule 606(a) further requires a broker-dealer to provide a “... description of any terms of such arrangements, written or oral, that may influence a broker’s or dealer’s order routing decision including, among other

⁵ 17 CFR §242.606(a).

⁶ Securities Exchange Act Release No. 84528 (Nov. 2, 2018), 83 FR 58338 (Nov. 19, 2018).

⁷ Securities and Exchange Commission, “Responses to Frequently Asked Questions Concerning Rule 606 of Regulation NMS,” available at <https://www.sec.gov/tm/faq-rule-606-regulation-nms>. Securities and Exchange Commission, Division of Examinations, “Risk Alert: Observations Related to Regulation NMS Rule 606 Disclosures” (Nov. 10, 2022), available at <https://www.sec.gov/files/reg-nms-rule-606-disclosures-risk-alert.pdf>.

⁸ 17 CFR §242.606(a).

⁹ Id.

things: (A) Incentives for equaling or exceeding an agreed upon order volume threshold....”¹⁰ Once again, the reporting broker-dealer does not have these arrangements in place with the venue in connection with the routing firm scenario.

It quickly became apparent after the adoption of Rule 606(a) that the wording of the rule (i.e., the requirement to disclose “... the material aspects of the broker’s or dealer’s relationship with each venue identified”) makes no sense as applied to the routing firm scenario. At that point, the Commission should have proposed amendments to Rule 606(a) for public comment. Specifically, the Commission should have proposed that for the routing scenario a firm should report the routing broker in the Rule 606(a) table. Alternatively, the Commission should have provided guidance that a reporting firm can report the routing firm in the routing scenario, or the Commission should have provided appropriate exemptive relief. Instead, subsequent to the 2018 Amendments, the Commission has provided guidance that is inconsistent with the wording of the amended Rule 606(a) and the 2018 Adopting Release.

Why look-through obscures relevant information from retail customers

There are many scenarios where a customer-facing broker-dealer (the “reporting firm”) will route an OTC equity order to a second broker-dealer that is neither a market maker nor an alternative trading system (the “routing firm”). The routing firm will then manage further routing and execution of the order. To understand the financial inducements faced by the reporting firm in this scenario, the relevant information is the payment received by the reporting firm from the routing firm (or, as applicable, the payment made by the reporting firm to the routing firm). Accordingly, to achieve the stated objective of the FINRA Rule Filing, it is important in this scenario that the reporting firm report the routing firm in the venues table proposed by FINRA.¹¹

If the reporting firm instead reports the venue to which the routing firm further routes the customer’s order and the associated fee arrangement between the routing firm and that downstream venue, this obscures the financial inducements faced by the reporting firm. In particular, any payment for order flow made by the routing firm to the reporting firm will not be disclosed in the venues table. This is contrary to the stated objective of the Rule Filing.

In the Rule Filing, FINRA discusses the anticipated benefits of the proposed rule. FINRA writes that “[i]n the absence of the proposed disclosures, investors may not know where a broker-dealer routes orders for execution or whether the broker-dealer receives payments or rebates from such venues.”¹² With look-through, the payments and rebates received by the reporting firm are removed from the venues table. This is directly contradictory to the stated objective of the Rule Filing as cited above in this paragraph.

¹⁰ Id.

¹¹ FINRA provides the format for the venues table in Exhibit 3 to the Rule Filing.

¹² Rule Filing, at 20.

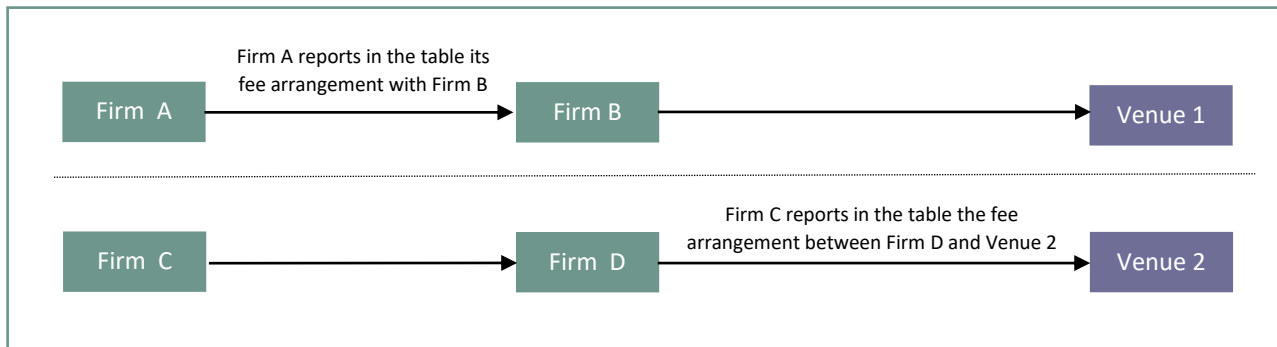
With look-through, the reported data is no longer comparable across broker-dealers; this is detrimental to retail investors and contrary to FINRA’s stated objectives in the Rule Filing

In the Rule Filing, FINRA identifies as an anticipated benefit of the rule proposal the ability of a customer to compare routing activity across broker-dealers:

Standardized reports, which would be available on the member’s website and centralized on FINRA’s website, would allow customers to compare order routing practices across different firms and observe changes in a firm’s routing behavior over time. Customers would be able to better compare indirect trading costs and whether payment for order flow received and net transaction fees paid, considering rebates, may be affecting the routing decisions of some firms more than others or causing changes in routing behavior over time. The information in these reports would permit customers to evaluate firms’ routing decisions more effectively and be better informed in making choices among firms.¹³

As proposed by FINRA, if Reporting Firm A routes directly to Firm B, and Firm B can execute orders, while Reporting Firm C routes to Routing Firm D, and Routing Firm D cannot execute orders, Firm A would be reporting in the FINRA venues table the financial arrangements between Firms A and B, while Firm C would be reporting in the FINRA venues table the financial arrangements between Routing Firm D and each execution venue to which Firm D routes orders. This means that the data reported by Reporting Firms A and C is not comparable. This lack of comparability is detrimental to retail investors and inconsistent with an important stated objective of the rule proposal (comparability of reports), as quoted above.

The following diagram illustrates the scenario described in the preceding paragraph and how look-through results in lack of comparability of data across broker-dealers (in conflict with the objectives of the rule proposal, as stated by FINRA):



¹³ Rule Filing, at 22.

Look-through requires firms to report on financial arrangements that they are not a party to

As the diagram above illustrates, look-through requires a reporting firm to report on financial arrangements between a routing firm and a venue when the reporting firm is not a party to those financial arrangements. The rule requires the reporting firm to collect this data from the routing firm but imposes no obligation on the routing firm to provide this data. This is another very problematic aspect of the look-through requirement.

A reporting firm cannot effectively validate look-through data

Because a reporting firm is not a party to the look-through arrangements that the reporting firm is required to report, the reporting firm cannot effectively validate the look-through data relating to these arrangements.

The approach recommended by FIF members provides clearer disclosure to retail customers and addresses all of the problems with look-through

As an alternative to look-through, FIF members recommend that in the routing scenario the reporting firm should report the routing broker in the venues table. This provides clear disclosure to the retail customer as to the fee arrangements between the reporting firm and each firm to which it routes orders. This very straightforward solution also avoids the other problems with look-through as discussed in this letter.

The Rule Filing does not discuss the costs for reporting look-through

As the Commission and FINRA are fully aware based on communications with industry members over the past few years, the costs for reporting look-through are significant (and possibly the most significant aspect of the costs for Rule 606 reporting). Reporting look-through is costly because a reporting firm is required to report on financial arrangements to which the reporting firm is not a party. The reporting firm must collect this data for reporting tabular data and also for reporting material aspects disclosures. The Commission's requirements for material aspects disclosures involve significant complexity for a firm reporting arrangements with the firms and venues to which the reporting firm directly routes orders. Requiring a reporting firm to report these arrangements when the reporting firm is not a party to the arrangements magnifies this complexity. Look-through also magnifies the quantity of data that must be collected and disclosed because a reporting firm could route orders to multiple routing firms, and each routing firm could route orders to multiple venues. When this quantity of look-through data is disclosed in material aspects, it can obscure disclosures relating to direct routing arrangements that would be more relevant for a customer's understanding of the routing arrangements of the reporting broker-dealer.

Because the Rule Filing does not discuss this significant (and possibly the most significant) expense related to reporting of order routes, FINRA, if it determines to proceed with look-through, should withdraw the Rule Filing and resubmit an updated rule filing with a discussion of these costs. In

particular, FINRA should update the “Anticipated Costs” section of the Rule Filing¹⁴ to consider the costs for firms to implement look-through.

Look-through should not apply for routes to foreign routing firms

In many cases, a reporting firm will not have direct membership in the exchanges and other execution venues of a foreign market. In this scenario, the reporting firm can route an order to a routing firm in the foreign market, and the routing firm can access the exchanges and other venues in the foreign market. FINRA should make clear that look-through would not apply in this scenario.

If FINRA determines to proceed with look-through, FINRA should redraft proposed Rule 6470 to accurately reflect the reporting that it is requiring

As discussed above, FIF members are opposed to applying look-through under proposed Rule 6470. If FINRA considers it necessary to apply look-through under Rule 6470, at a minimum FINRA should resubmit the Rule Filing with wording in the rule that addresses the routing scenario. Proposed Rule 6470 copies significant portions of Rule 606(a). As a result, it similarly makes no sense as applied to the routing scenario. The Rule Filing provides guidance relating to look-through on pages 30-31 of the Rule Filing, but the concept of look-through, because it is fundamental to how firms would be required to report, should be incorporated into the wording of the rule itself. If FINRA wants look-through to apply, FINRA should withdraw the Rule Filing and resubmit a rule filing that incorporates this concept in the rule itself.

II. Data available in the CAT system

FINRA should consider whether certain categories of data that firms are required to report in the proposed OTC routing reports could be obtained by FINRA from the Consolidated Audit Trail (“CAT”) reporting system and then disseminated by FINRA. This would apply to the routing venue data in the proposed OTC routing reports and not the data relating to payment for order flow and transaction fees. For firms that do not have payment for order flow and similar financial arrangements in place with venues to which they route, the CAT system presumably would have all the data that these firms would be required to report under proposed FINRA Rule 6470.

III. OTC Link ATS

The Rule Filing does not provide guidance on reporting various scenarios relating to trading on the OTC Link ATS. Before any implementation period can commence, it is important that FINRA publish clear written guidance on all applicable OTC Link ATS workflows and how these workflows should be reported. Prior to issuing this guidance, FINRA should engage in discussions with representatives of OTC Link and the industry members that are participants in OTC Link.

¹⁴ Rule Filing, at 23-25.

IV. Reporting timeframe

FIF members agree with FINRA's proposal to maintain the same quarterly reporting timeframe as applies for Rule 606(a) reporting.¹⁵

V. Centralized publication of reports

FIF members support centralized publication of Rule 606(a) reports and the proposed OTC routing reports through the FINRA website in a manner that can be accessed by all market participants at no cost.¹⁶ If FINRA will publish all Rule 606(a) and OTC routing reports, it should no longer be required for firms to separately publish these reports on their own websites. Instead, it should be required for a firm to provide a link from its public website to the applicable section of the FINRA website. FIF members also recommend that FINRA consider creating a database with structured firm routing report data that industry members and other market participants could access through automated queries.

VI. Categories of OTC equity securities

FIF members believe that the reporting categories proposed by FINRA are appropriate.¹⁷ FIF members note that there are a significant number of OTC stocks that have a limited number of available execution venues, and that these stocks would not be reported separately based on FINRA's proposed categories. This is an example where securities with different trading characteristics would be included in the same reporting category. Setting the reporting categories involves a trade-off between providing a report that is comprehensible for individual investors, on the one hand, and providing additional granularity and detail, on the other hand. On the whole, FIF members believe that it is important not to over-complicate the report for individual investors and support the categories proposed by FINRA.

VII. Symbol file

FIF members appreciate and support the decision of FINRA to publish and maintain a file of which symbols are included in each OTC equity category and that this file be accessible to all industry members without charge.¹⁸ FIF members recommend that FINRA make this symbol file available to industry members prior to the first day of each quarter, and industry members would report those symbols for the upcoming quarter. For example, FINRA would make the symbols for the 2nd quarter of a year available prior to April 1, and industry members would report those symbols for the 2nd quarter reports that are due by the end of July. Requiring industry members to process daily updates to a reportable symbol list would significantly increase the reporting burden for firms and would not have any material impact on the aggregated data that firms would be reporting for a particular quarter.

¹⁵ Rule Filing, at 5-6.

¹⁶ Id. at 12-14.

¹⁷ Id. at 6.

¹⁸ Id.

VIII. OTC stocks that have a limited number of available execution venues

There are a significant number of OTC stocks that have a limited number of available execution venues. In many cases, an OTC stock will only have one or two market makers. There is a potential risk that investors viewing the report for these stocks would see a high percentage of order flow being routed to one or two venues without appropriate context of the limited choices available to the reporting firm. FINRA should identify this as a factor for investors to consider when reviewing a broker-dealer's OTC routing report. FIF also notes that some firms with lower trading volume in OTC equities could have routing relationships with a limited number of market makers.

IX. Order types

FIF members support FINRA's approach of not breaking out the report by order type.¹⁹ Classifying a limit order as marketable or non-marketable is contingent on a best bid and offer ("BBO") being available on a continuous basis. Since market makers are not mandated to provide continuous firm quotes for OTC equities, there is no certainty of a BBO being available on a continuous basis for any OTC equity. This means that classifying limit orders as marketable or non-marketable is not feasible. Further, since marketable limit orders share certain characteristics with marketable orders, differentiating between market and limit orders without separately differentiating between marketable and non-marketable limit orders could be misleading.

X. Disclosing aggregate payments

FIF members agree with FINRA's proposal to require reporting of payments per executed order rather than per share, as this is consistent with current industry practice for OTC equities.²⁰

XI. Held and not held orders

FIF members support FINRA's proposal to limit the OTC routing reports to non-directed held orders.²¹ The proposed OTC routing reports are intended for retail investors; limiting the report to held orders is consistent with this focus. The Rule Filing would require firms to report for each category of orders the percentage of not held and held orders as a percentage of all orders. FIF members request that the Commission and FINRA provide further guidance as to whether there can be orders that are neither held orders nor not held orders.

In connection with the Commission's 2018 Amendments to Rule 606, the Commission introduced a new 606(b)(3) report, which requires broker-dealers to disclose data to customers relating to the routing of not held orders.²² In contrast to the Rule 606(a) report, which is focused on retail investor orders, the Rule 606(b)(3) report is focused on institutional investor orders. In contrast to the Rule 606(b)(3) tables, which the Commission designed to include look-through data, the Rule 606(a) tables were never

¹⁹ Id. at 12.

²⁰ Id.

²¹ Id. at 9.

²² 17 CFR §242.606(b)(3).

intended to include look-through data and, accordingly, were not designed to accommodate look-through reporting.

On March 2, 2022, FIF submitted a comment letter in connection with a request submitted by the Commission to the Office of Management and Budget for approval of an extension of the previously approved collection of information provided for in Rule 606.²³ In the March 2022 comment letter, FIF recommends that Rule 606(b)(3) be rescinded, “[b]ased on the minimal volume of requests for Rule 606(b)(3) reports and the significant ongoing costs for firms to maintain the infrastructure to comply with these requests....”²⁴ FIF reports in the comment letter that “... the actual volume of customer requests for Rule 606(b)(3) reports is significantly lower than the volume of requests that was projected in the 2018 Adopting Release.”²⁵

XII. Exemption for venues that receive less than 5% of non-directed orders

FIF members support the proposal from FINRA to exempt firms from including on their OTC routing reports venues that receive less than 5% of a firm’s non-directed held orders for the applicable OTC order category as long as the firm has disclosed on the report venues that have received at least 90% of the firm’s total non-directed held orders for the applicable OTC order category. As noted in the Rule Filing, this proposal is consistent with the approach adopted by the Commission with respect to Rule 606(a) reporting.²⁶

XIII. Implementation timeframe

The industry required significant time to implement the Commission’s 2018 Amendments to Rule 606, resulting in the Commission granting an extension of the implementation dates that were provided for in the 2018 Amendments.²⁷ Two significant and related contributors to the implementation delay were the industry’s need for regulatory guidance relating to the amendments and the complexity of the look-through reporting requirements. It is critical that the implementation schedule for any rule change allow sufficient time for industry members to identify and obtain guidance from FINRA on applicable interpretive questions. We also importantly note, based on experience with implementation of the 2018 Amendments to Rule 606, that removing the look-through requirement would significantly reduce the implementation timeframe for the proposed OTC routing reports.

It is important to ensure that industry members will have sufficient time to properly implement the planned reporting changes. Any implementation timetable should run from the date that FINRA publishes technical specifications, schemas, interpretive FAQs and other applicable documentation. As discussed above, this documentation should include guidance relating to OTC Link trading workflows. In

²³ OMB Control No. 3235–0627, 87 FR 4312 (Jan. 27, 2022).

²⁴ Letter dated March 2, 2022 from the undersigned to David Bottom, Director/Chief Information Officer, Securities and Exchange Commission, c/o John Pezzullo, available at <https://fif.com/index.php/working-groups>, at 6.

²⁵ Id. at 2, 5-6. This assertion was based on a survey of members that FIF conducted as to the volume of customer requests for Rule 606(b)(3) reports that firms received during 2021.

²⁶ Id. at 9-10.

²⁷ Exchange Act Release No. 85714 (Apr. 29, 2019), 84 FR 18136 (Apr. 30, 2019).

setting implementation timelines, FINRA also should consider that in many cases firm personnel who will be responsible to focus on implementation of the OTC routing report requirements proposed in the Rule Filing also will be responsible to focus on the recent amendments to Rule 605 proposed by the Commission.²⁸

XIV. Insufficient comment period

The Commission has not provided market participants an adequate period of time to comment on this highly problematic rule proposal. In particular, FINRA did not discuss look-through in the Regulatory Notice that FINRA published on OTC order routing reports, and FINRA is only introducing look-through at this stage in the process.²⁹ As an industry association, FIF seeks input from a wide group of members, and many of our member firm participants are not available during much of the last two weeks of December. This means that the effective period for FIF to comment on the FINRA Rule Filing is 14 days (December 6 to December 20). Given this insufficient comment period, FIF will consider submitting supplemental comments during January 2023.

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FIF appreciates the opportunity to comment on SR-FINRA-2022-031. If you would like clarification on any of the items discussed in this letter or would like to discuss further, please contact me at howard.meyerson@fif.com.

Very truly yours,

/s/ Howard Meyerson

Howard Meyerson
Managing Director, Financial Information Forum

²⁸ Securities Exchange Act Release No. 96493 (Dec. 14, 2022) (Disclosure of Order Execution Information).

²⁹ FINRA Regulatory Notice 21-35, "Order Routing Disclosures for OTC Equity Securities: FINRA Requests Comment on Proposed Order Routing Disclosure Requirements for OTC Equity Securities and Potential Steps to Facilitate Investor Access to Current Order Routing Disclosures for NMS Securities," available at <https://www.finra.org/sites/default/files/2021-10/Regulatory-Notice-21-35.pdf>.