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MEMORANDUM

[34801]	
January 12, 2023	
TO:	Closed-End Investment Company Committee Equity Markets Advisory Committee ETF (Exchange-Traded Funds) Committee SEC Rules Committee Security Valuation Operations Committee
RE:	SEC Proposes to Expand Order Execution Disclosures Under Rule 605 of Reg NMS

On December 14, 2022, the Securities and Exchange Commission (SEC or "Commission") issued a proposal ("Proposal") to update the disclosure required under Rule 605 of Regulation National Market System ("Reg NMS")[1] that would: (1) expand the scope of entities subject to the rule; (2) update the scope and content of the standardized monthly reports required under the rule; and (3) require entities subject to the rule to make a summary report available in a human readable format.[2] The Proposal is one of four proposals the Commission issued on December 14 that, if adopted, would represent the most sweeping overhaul of the US equity market structure since the adoption of Reg NMS in 2005.[3]

Given the breadth and complexity of the four proposals, we have prepared a separate member memo on each proposal. The proposals are interrelated, however, and it will be important to analyze the implications of each proposal for the others, as well as the implications of the proposals in total. As of today, the comment deadlines for the Proposal and the Best Execution Proposal will remain open until March 31, 2023, or 60 days after the date of publication of the proposing release in the Federal Register, whichever is later. Comments on the Tick Size Proposal and the Auction Proposal are due on March 31. We will hold an initial 75-minute member call on Thursday, January 19, at 12:00 Noon (ET) to discuss these proposals and ICI's response. If you would like to join that call, the Zoom participation information is:

https://ici-org.zoom.us/j/94142244626?pwd=ZWdDNzdiYUlJZkE3SVZzQlRDTmlFdz09

Meeting ID: 941 4224 4626

Passcode: 898596

Expansion of Covered Entities

Currently, Rule 605 requires only "market centers" to make publicly available, on a monthly basis, a standardized report concerning the execution quality for covered orders in NMS stocks that they received for execution. Reg NMS defines a "market center" as any exchange market maker, over-the-counter (OTC) market maker, alternative trading system (ATS), national securities exchange, or national securities association.

The Proposal would expand the scope of entities covered under Rule 605 to also include: (i) broker-dealers that introduce or carry 100,000 or more customer accounts ("customer account threshold");[4] (ii) single-dealer platforms (SDPs) and ATSs – separate from their broker-dealer operator's other activities; and (iii) entities that would operate "qualified auctions" under the proposed Order Competition Rule.[5]

The Commission notes that expanding the scope of Rule 605 to include large broker-dealers with a customer-facing line of business would allow market participants to compare execution quality across broker-dealers. The Proposal also suggests that requiring SDPs[6] and ATSs to produce Rule 605 reports separately from their broker-dealer operators would allow market participants to distinguish SDP and ATS activity from more traditional dealer activity.[7]

If the proposed Order Competition Rule is adopted, the Commission would require market centers operating a qualified auction to prepare a separate Rule 605 report pertaining only to covered orders received for execution in a qualified auction. The Proposal states that it would be more useful for market participants to be able to review such reports separately, as execution quality for those orders may differ from that for orders executed outside qualified auctions.

The Commission requests comment on all aspects of the expansion of Rule 605 reporting entities, including whether it would be useful for customers of certain broker-dealers to be able to review Rule 605 reports specific to those broker-dealers instead of relying on execution quality statistics reported by the market centers to which the broker-dealers route orders.[8]

Proposed Modifications to Scope of Orders Covered and Required Information

Rule 605 reports contain various execution quality metrics for covered orders, and the information is categorized by individual security, one of five order types, and one of four order sizes. The Commission proposes to update the scope and content of Rule 605 reports by: (i) expanding the definition of "covered order" to include certain additional order types; (ii) modifying the existing order size categories; and (iii) creating a new order type category as well as replacing three existing order type categories.

The Proposal would also require more granular execution quality statistics and introduce new reportable statistics regarding price and size improvement.

Expanded Definition of Covered Order

The Proposal would expand the definition of "covered order"[9] under Regulation NMS to include:

- Non-marketable limit orders (NMLOs)received outside regular trading hours or while a national best bid and offer (NBBO) is not being disseminated, if they became executable during (and were not executed outside of) regular trading hours;[10]
- Executable orders with stop prices;[11] and
- Non-exempt short-sale orders unless a price test restriction is in effect for the security[12]

Changes in Order Size Categories

The Commission proposes to modify the existing order size categories to base them on round lotsinstead of number of shares – using the recently amended definition of round lot,[13] and to establish new order size categories for fractional shares, odd-lot, and larger-sized orders. Specifically, under the Proposal, the order size categories would change as follows:

Existing Order Size Category	Order Size Category as Proposed
[not in Rule 605 report]	(i) Less than 1 share
[not in Rule 605 report]	(ii) Odd-lot
(i) 100 to 499 shares	(iii) 1 round lot to less than 5 round lots
(iii) 500 to 1999 shares	(iv) 5 round lots to less than 20 round lots
(iv) 2,000 to 4,999 shares	(v) 20 round lots to less than 50 round lots
(v) 5,000 shares or more	(vi) 50 round lots to less than 100 round lots
10,000 or more shares [not in Rule 605 report]	(vii) 100 round lots or greater

The Proposal explains that basing the order size categories on round lots would better allow Rule 605 reports to group orders with similar characteristics and notional values, and thereby provide more useful execution information.[14] The Commission also suggests that including odd-lot orders, fractional shares orders, and larger-sized orders[15] would improve execution quality statistics by including information about important segments of order flow.

Changes in Order Type Categories

Under Rule 605, the information in monthly reports is also categorized by order type. The proposed rule changes would modify the current order type categories as follows:

Existing Order Type Category	Order Type Category as Proposed
Market	Market Marketable IOC
Marketable Limit	Marketable Limit Marketable IOC
Inside-the-Quote Limit	Beyond-the-Midpoint Limit Executable NMLO
At-the-Quote Limit	Executable NMLO
Near-the-Quote Limit	Executable NMLO
[Not Included][16]	Executable NMLO Executable Stop

Current Rule 605 reports group marketable IOCs together with other marketable orders. The Proposal would assign marketable IOCs to a separate order type category, as the Commission notes that such orders may have a different submitter profile (typically, institutional investors) and different quality statistics. The Commission would continue to require the same execution quality statistics of marketable IOCs that is required for other marketable order types, as well as specify that the category for "marketable limit orders" excludes IOC orders.

The Commission also proposes to eliminate the current three separate categories for types of NMLOs (inside-the-quote limit orders, at-the-quote limit orders, and near-the-quote limit orders) and replace them with two new categories: (i) executable NMLOs[17] (excluding stop orders[18] and beyond-the-midpoint limit orders) and (ii) beyond the-midpoint limit orders.[19]

The Proposal would add beyond-the-midpoint limit orders to each of the lists for marketable and non-marketable order categories, thus requiring that the execution quality statistics for such orders include the additional information required of both marketable and non-marketable order types. Additionally, the Commission would modify the "time to order execution statistics" to state that, with respect to beyond-the-midpoint limit orders, such time-based statistics should be measured from the time such orders become executable to the time of order execution.

Changes in Timestamp Conventions

Rule 605 reports are required to include information on the number of shares of covered orders executed within certain timeframes, measured "by seconds" after the time of order receipt. The Proposal would update the timestamp conventions for Rule 605 reports to require that the following be measured and expressed in increments of a millisecond or finer: "time of order receipt;" "time of order execution;" the "average time-to-execution" statistics required for marketable order types; and the time an order becomes "executable."

The Proposal would also eliminate the current "time-to-execution" buckets[20] and instead require the reporting of: share-weighted average time to execution for non-marketable order types (in addition to reporting of this metric for marketable order types, as is currently required);and statistics regarding the distribution of execution times within each order type (*i.e.*, the share-weighted median and 99th percentile time-to-execution).[21] The Commission notes that these amendments would provide more meaningful information about the distribution of execution times within each order type.

Changes to Information Required for All Order Types & Additional Information Required for Certain Order Types

The Proposal would make the following changes to information required under Rule 605 for all order types:

- Calculating the average realized spread at specified intervals of 15 seconds and one minute after the time of order execution, instead of five minutes after execution as currently required.
- Reporting of average effective spreads and, for certain orders (*i.e.*, executable NMLOs, beyond-the-midpoint-limit orders, and executable stop orders), calculation of this metric from the time the order becomes executable.[22]
- Reporting of average realized spread and average effective spread as percentages, in addition to reporting in dollar amounts, as is currently required.
- Calculating a statistic for average effective over quoted (E/Q) spread, expressed as a percentage, which would represent how much price improvement an order received.
- Adding a benchmark metric that would, in combination with information about execution sizes, indicate the level of size improvement[23] (*i.e.*, whether orders received an execution greater than the displayed size at the quote).[24]
- Reporting of riskless principal orders as executed at another venue, rather than as executed at the market center, broker, or dealer that, to fulfill the customer order, submits a principal order to an away market center.[25]

The Commission would also require certain additional information for market, marketable limit, marketable IOC, and beyond-the-midpoint limit orders. Specifically, the Proposal would first add a definition for "best available displayed price" and two new terms related to this definition.[26] The Proposal would also add to Rule 605(a)(1)(ii) additional price improvement statistics specifically related to the best available displayed price,[27] which the Commission states would allow market participants to evaluate how well market centers and broker-dealers perform executing covered orders relative to the best available displayed price.

Finally, the Proposal would require additional information for executable NMLOs, executable stop orders, and beyond-the-midpoint limit orders. In particular, the Commission would require reporting of the: (i) number of orders that received either a complete or a partial fill; and (ii) cumulative number of shares executed regular way at prices that could have filled the order while it was in force, as reported pursuant to an effective transaction reporting plan or NMS plan.

The Proposal requests comments on all aspects of the expanded monthly report requirements.[28]

Summary Execution Quality Reports

The Proposal would require Rule 605 reporting entities to make publicly available for each calendar month a report providing summary execution quality statistics only on covered orders that are market and marketable limit orders.[29]

The proposed summary reports would include a section for NMS stocks that are included in the S&P 500 as of the first day of the month and a section for other NMS stocks. Moreover, under the Proposal, each section of the summary report would include certain summary statistics for executed orders, equally weighed by symbol based on share volume.[30]

The Proposal would require Rule 605 reporting entities to make the summary reports available in XML and PDF format, as published on the Commission's website. The Commission would further require reporting entities to provide the summary reports within one month after the end of the month addressed in the report, and to post the summary reports (along with the detailed Rule 605(a)(1) reports[31]) on an internet website that is free and readily accessible to the public for a period of three years from the initial date of posting.

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Notes

[1] ICI has previously supported updating or expanding Rule 605 (and Rule 606) of Regulation NMS to provide additional information to investors. *See* Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC (April 21, 2010),

available at https://www.ici.org/system/files/attachments/24266.pdf. While Rule 605 has not been substantively updated since it was adopted in 2000, following an ICI-led initiative, the Commission amended Rule 606 in 2018 to improve the transparency of broker-dealers' order handling practices. *See* ICI Memorandum No. 31488 (Nov. 19, 2018), *available at* https://www.ici.org/memo31488.

[2] *Disclosure of Order Execution Information*, Exchange Act Rel. No. 34-96493 (Dec. 14, 2022) ("Proposing Release"), *available at* https://www.sec.gov/rules/proposed/2022/34-96493.pdf. The Proposal notes that while institutional investors have access to alternative sources of execution quality information, such as Rule 606(b)(3) reports and transaction cost analysis, such information is limited to the execution quality obtained from broker-dealers with which the institutional investor currently does business. The Commission states that since Rule 605 reports are public, institutional investors could use these reports to assess the execution quality of broker-dealers and market centers with which they do not currently do business. Proposing Release at 192 n. 507.

[3] *Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders*, Exchange Act Rel. No. 34-96494 (Dec. 14, 2022) ("Tick Size Proposal"), *available at* https://www.sec.gov/rules/proposed/2022/34-96494.pdf; *Order Competition Rule*, Exchange Act Rel. No. 34-96495 (Dec. 14, 2022) ("Auction Proposal"), *available at* https://www.sec.gov/rules/proposed/2022/34-96495.pdf; *Regulation Best Execution*, Exchange Act Rel. No. 34-96496 (Dec. 14, 2022) ("Best Execution Proposal"), *available at* https://www.sec.gov/rules/proposed/2022/34-96496.pdf.

[4] A broker-dealer that meets the customer account threshold *and* that is also a market center would be required to produce separate Rule 605 reports for each function. Broker-dealers that meet the customer account threshold would be required to produce Rule 605 reports for at least three calendar months, even if, at times, they fall below the customer account threshold. *See* Proposing Release at 60.

[5] *See* Auction Proposal. The Commission clarifies, however, that a market center or broker-dealer that routes covered orders to an "open competition trading center" for execution within a qualified auction, would not be required to separately report or otherwise distinguish those orders from other types of orders routed away for execution in its Rule 605 reports.

[6] The Proposal notes that some OTC market makers, such as wholesalers, operate SDPs through which they execute institutional orders against their own inventory, and that institutional customers often communicate their trading interest using immediate-or-cancel orders (IOCs) or indications of interests (IOIs) on SDPs.

[7] Proposed Rule 605(a)(1) would require that any market center that provides a separate routing destination that allows persons to enter orders for execution against the bids and offers of a single dealer must produce a separate report pertaining only to covered orders submitted to such routing destination.

[8] *See* Proposing Release at 66-70, 75-76, 80.

[9] The Commission suggests that although institutional investors tend to use "not held" orders, which are excluded from definition of "covered order," institutional investors may still find relevant information in Rule 605 reports, as large institutional "parent" orders are often split into multiple smaller "child" orders, which may be handled as held orders and reflected in Rule 605 reports. *See* Proposing Release at 207-210.

[10] Proposed Rule 600(b)(30), (42). Reporting entities would also need to include in Rule 605 reports any covered orders received for execution in a prior calendar month, but which remained open. *See* Proposing Release at 82-87.

[11] Proposed Rule 600(b)(42) (providing a specific definition of "executable" for orders with a stop price).

[12] Non-exempt short sale orders are subject to a price test under Rule 201 of Regulation SHO, which provides that a short sale circuit breaker is triggered in certain circumstances, after which time a price restriction will apply to short sale orders in that security for that day and the following day. *See* Proposing Release at 90-91.

[13] In 2020, the Commission adopted rule amendments that expanded NMS market data content and that, among other things, established a price-based definition of "round lot." *Market Data Infrastructure*, Exchange Act Release No. 34-90610 (Dec. 9, 2020) ("MDI Adopting Release"), *available at* https://www.sec.gov/rules/final/2020/34-90610.pdf; *see* ICI Memorandum No. 33240 (March 17, 2021), *available at* https://www.ici.org/memo33240. The Commission had established an implementation transition plan in which implementation of the new round lot definition would be at least two years after approval of the plan. *See* Proposing Release at n. 266. The Commission now separately proposes to accelerate the implementation of the new round lot definition. *See* Tick Size Proposal.

[14] The Commission suggests that this is especially true because many of Rule 605's execution quality measures rely on the NBBO as a benchmark, and the NBBO itself will be calculated based on the new definition of round lot (once that definition is implemented).

[15] Rule 605 does not include orders with a size of 10,000 shares or greater pursuant to SEC exemptive relief issued in 2001. The Commission believed that such relief would help assure greater comparability of statistics in the largest size category of 5,000 or more shares. *See* Proposing Release at n.40, 102. The Proposal would rescind this relief.

[16] The following orders fall outside the scope of the current order type categories: (1) NMLOs with limit prices more than $0.10 away from the NBBO at the time of order receipt, and (2) stop orders. Under the Proposal, such orders, if they become executable, would be included as executable NMLOs or executable stop orders. *See* Proposing Release at 106-107, n. 292.

[17] *See* proposed Rule 600(b)(42) (defining "executable" for NMLOs (other than orders submitted with stop prices)).

[18] The Proposal would add a separate order type category for "executable stop orders."*See also supra* note 10.

[19] *See* proposed Rule 600(b)(16) (defining "beyond-the-midpoint limit order").

[20] *See* Rule 605(a)(1)(i)(F), (G), (H), (I) and (J) (detailing time-to-execution buckets of 0 to 9 seconds, 10 to 29 seconds, 30 to 59 seconds, 60 to 299 seconds, and 5 to 30 minutes after the time of order receipt).

[21] *See* Proposing Release 122-124.

[22] Currently, average effective spread must be calculated only for marketable order types and doing so requires comparing the execution price of an order with the midpoint of the NBBO at the time of order receipt.

[23] *See* Proposing Release at 140-145. Specifically, proposed Rule 605(a)(1)(i)(F) would require, for executions of all covered orders, the reporting of the cumulative number of shares of the full displayed size of the protected bid at the time of execution, in the case of a market or limit order to sell and, in the case of a market or limit order to buy, the full displayed size of the protected offer at the time of execution.

[24] The Proposal suggests that market participants, including institutional investors, have raised concerns in the past about reduced price transparency and difficulty executing large transactions at the best prices. *See* Proposing Release at 142 n. 408 (citing Letter from Craig Tyle, General Counsel, ICI, to Jonathan Katz, Secretary, SEC (Nov. 20, 2001) *available at* https://www.sec.gov/rules/concept/s71401/tyle1.htm#P41_3920).The Commission believes that the use of size improvement statistics could help address these concerns by providing information relating to which market centers and broker-dealers are more likely to be able to fill larger-sized orders at or better than the NBBO.

[25] Proposed rule 605(a)(1)(i)(D) would provide that the number of shares of covered orders executed at the receiving market center, broker, or dealer excludes shares which such reporting entity executed on a riskless principal basis. The Proposal would require the market center that executes the riskless principal order to include these shares as part of the "cumulative number of shares executed at any other venue" under Rule 605(a)(1)(i)(E).

[26] *See* proposed Rules 600(b)(14), (44), (47). The definition of best available displayed price would include the best priced odd-lot if that price is inside the NBBO. The Commission is separately proposing to, among other things, amend the definition of "odd-lot information" to include a new data element to identify the best odd-lot orders available in the market inside the NBBO. *See* Tick Size Proposal.

[27] *See* Proposing Release at 153.

[28] *See* Proposing Release at 93-94, 104, 117, 125-126, 147-149, 155, and 159.

[29] Proposed Rule 605(a)(2). The Commission suggests that, because individual investors would be the most likely consumers of the summary reports and they primarily trade NMS stock using market and marketable limit orders, it would be beneficial for summary reports to cover the types of orders that individual investors use most frequently.

[30] The Proposal would require the following summary statistics: (i) the average order size; (ii) the percentage of shares executed at the quote or better; (iii) the percentage of shares that received price improvement; (iv) the average percentage price improvement per order; (v) the average percentage effective spread; (vi) the average effective over quoted spread, expressed as a percentage; and (vii) the average execution speed, in milliseconds.

[31] The Commission believes that institutional investors, due to their greater resources, may be more likely than individual investors to access rule 605 reports directly, and that some institutional investors may currently use aggregated statistics or summaries of Rule 605 reports prepared by third parties, which make these reports available for a fee. The Commission also suggests that investment advisers, consistent with their duty of care (which includes seeking best execution of a client's transactions when selecting broker-dealers to execute client trades), typically use Rule 605 reports as part of their internal review of execution quality. *See* Proposing

Release at 207-211.