

**MEMO# 29521**

December 3, 2015

## **SEC Proposes Rules for the Regulation of NMS Stock Alternative Trading Systems; Member Call Scheduled for December 14 at 12:00 p.m.**

[29521]

December 3, 2015

TO: ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 29-15  
ETF ADVISORY COMMITTEE No. 28-15  
EQUITY MARKETS ADVISORY COMMITTEE No. 27-15  
FIXED-INCOME ADVISORY COMMITTEE No. 35-15  
SEC RULES COMMITTEE No. 37-15 RE: SEC PROPOSES RULES FOR THE REGULATION OF NMS STOCK ALTERNATIVE TRADING SYSTEMS; MEMBER CALL SCHEDULED FOR DECEMBER 14 AT 12:00 P.M.

The Securities and Exchange Commission (“SEC” or “Commission”) recently proposed rules to amend the regulatory requirements applicable to alternative trading systems (“ATSs”). The proposed amendments would apply primarily to ATSs that offer trading in stocks listed on a national securities exchange (“NMS Stock ATSs”). [1] Broadly speaking, the proposal aims to provide investors, other market participants, and the Commission more information about the operation of NMS Stock ATSs. The proposal would require each of these trading systems to make detailed public disclosures on newly-proposed Form ATS-N about its operation and the activities of its broker-dealer operator and its affiliates. The proposal also would provide a process for the Commission to declare Form ATS-N filings effective or ineffective, review amendments to form ATS-N, and suspend or limit the ability of an NMS Stock ATS to operate. One provision of the proposal – regarding safeguards and procedures to protect confidential information – would apply to all ATSs. The comment period for the proposal closes 60 days after publication of the proposal in the Federal Register.

On December 14, 2015 at 12:00 p.m. (ET), we will hold a 60-minute member call to discuss the proposal. If your firm plans to participate in the call, please send an rsvp email to Hellenia Walker at [hellenia.walker@ici.org](mailto:hellenia.walker@ici.org), indicate the name of your firm and who from your firm will participate in the call. Hellenia will provide dial-in details to members who express interest.

## **Background**

Sections 5 and 6 of the Securities Exchange Act of 1934 (“Exchange Act”) require all “exchanges” to register with the SEC, and Section 3(a)(1) provides a definition of “exchange.”

In 1998, the Commission adopted Regulation ATS, which provides an exemption from exchange registration to trading venues that comply with the regulation. [2] Under Regulation ATS, each ATS must register as a broker-dealer and notify the Commission of its intent to operate by filing Form ATS, which requires the ATS to disclose specified information about itself, the types of subscribers who use the ATS, the ATS’s policies and procedures, and the operation of its trading system. [3] The ATS must update this information as required by SEC rules and must file a report summarizing its activity each quarter. Form ATS, amendments to the form, and ATS quarterly reports are deemed confidential by the SEC, and ATSs are not required to disclose publicly their trading services, operations, or fees.

## **Proposed Changes to NMS Stock ATS Registration and Regulation**

The SEC proposes to amend Regulation ATS to subject NMS Stock ATSs to more rigorous registration and disclosure requirements. The proposed rule would require each NMS Stock ATS to file with the Commission new Form ATS-N, which would compel the ATS to provide extensive information about the activities of its broker-dealer operator and affiliates and the operation of its trading system. In addition, the proposal would provide a process for the Commission to declare a Form ATS-N effective or ineffective and would require public disclosure of all effective Forms ATS-N. Finally, the proposal would provide a mechanism for the Commission to suspend, limit, or revoke an NMS Stock ATS’s ability to operate.

The SEC proposed these amendments to Regulation ATS because it was concerned that the lack of operational transparency around ATSs limits market participants’ ability to discern adequately how their orders interact, match, and execute on ATSs and to find the optimal market or markets for their orders. The SEC also is concerned about the current lack of transparency and potential conflicts of interest that arise from activities of the broker-dealer operator of the NMS Stock ATS and its affiliates in connection with the NMS Stock ATS.

## **Proposed Form ATS-N - Enhanced Reporting Requirements**

Proposed Form ATS-N would require each NMS Stock ATS to disclose significantly more information about the broker-dealer that operates the ATS and the operations of the ATS than is required today. The Commission believes these additional disclosures would increase transparency in the U.S. securities markets by allowing market participants to “better evaluate whether to do business with an ATS and make more informed decisions about where to route their orders.” [4] The Commission notes that the proposal also could facilitate comparisons among trading venues in NMS stocks, which could help customers of broker-dealers—such as funds—evaluate the quality of execution for orders routed to an NMS Stock ATS and aid customers in assessing the routing decisions of their brokers. [5] The Commission also notes that it is considering proposing to amend Exchange Act Rules 600 and 606 to standardize and improve transparency around how broker-dealers handle and route orders from institutional customers. The revisions being considered would include addressing concerns regarding broker-dealer disclosures about the trading venues to which they route orders, particularly with respect to order and execution sizes, fill rates, price improvement, and the use of actionable indications of interest. The Commission also is

considering disclosures to facilitate the ability of institutional investors to assess potential conflicts of interest and risks of information leakage. [\[6\]](#)

Moreover, the proposal would provide subscribers to an NMS Stock ATS, including institutional investor subscribers, more information about how the NMS Stock ATS operates, including how it matches and executes orders. These enhanced required disclosures are designed, in part, to assure that all market participants have access to the same amount of information about the operations and system functionalities of the NMS Stock ATS.

To help market participants assess potential conflicts of interest that may impact adversely their trading on the NMS Stock ATS, the SEC proposes a number of new disclosures. The proposed disclosures on the activities of an NMS Stock ATS's broker-dealer operator and its affiliates include:

- Operation of non-ATS trading centers and other NMS Stock ATSs;
- Products and services offered to subscribers (e.g., algorithmic trading products, market data feeds);
- Any arrangements with unaffiliated trading centers (e.g., preferential routing arrangements or mutual access arrangements);
- Trading activities on the NMS Stock ATS by the broker-dealer operator or its affiliates;
- Use of smart order routers ("SOR") (or similar functionality) and algorithms used to send or receive orders or other trading interest to or from the NMS Stock ATS, including what information about their orders is obtained by a SOR or algorithm and circumstances under which that information may be used by the broker-dealer operator;
- Shared employees of the NMS Stock ATS and third parties used to operate the NMS Stock ATS;
- Differences in the availability of services, functionalities, or procedures to subscribers and the availability of those services, functionalities, or procedures to the broker-dealer operator or its affiliates; and
- Safeguards and procedures to protect subscribers' confidential trading information.

The proposed disclosures on the operations of the NMS Stock ATS include:

- Eligibility requirements and any terms and conditions imposed on subscribers, including any arrangements with any subscribers to provide liquidity and any procedures to limit or deny access to the NMS Stock ATS;
- Hours of operation;
- Order types or other trading interest, such as indications of interest, that can be entered on the NMS Stock ATS, including their characteristics and operations and how they are handled on the NMS Stock ATS;
- Any connectivity, order entry, and co-location procedures or services;
- Segmentation of order flow, e.g., classification by type of participant, source, nature of trading activity, and notice given about segmentation;
- Display of order and other trading interest outside the NMS Stock ATS;
- Trading services, including matching methodologies, order interaction rules, and order handling and execution procedures;
- Procedures governing the suspension of trading and trading during a system disruption or other malfunction;
- Opening, re-opening and closing processes and after hours trading procedures;
- Outbound routing (discretion and means);
- Sources and use of market data, including how the NMS Stock ATS uses market data

to determine the NBBO, protected quotes, pricing of orders and executions, and routing destinations;

- Fees, rebates, or other charges of the NMS Stock ATS, including connectivity fees, subscription fees, execution fees, and volume discounts;
- Trade reporting, clearance and settlement arrangements or procedures;
- Order display and execution access and fair access information (for certain NMS Stock ATSs); and
- Market quality statistics published or provided to one or more subscribers.

## **Fixed Income ATSs**

As noted above, the proposed disclosure requirements of Form ATS-N would not apply to fixed income ATSs. The Commission preliminary believes that fixed income markets are sufficiently different from the equity markets and that any proposed revisions to the disclosure requirements for fixed income ATS under Regulation ATS should be tailored specifically to the attributes of the fixed income market. The Commission, however, recognizes that fixed income securities are increasingly being traded on ATSs and asks a number of questions regarding whether additional disclosure should be mandated for ATSs that trade fixed income securities.

## **Commission Effectiveness Determination**

The proposal would provide a mechanism for the Commission to declare a Form ATS-N effective or ineffective. This contrasts with the current notice registration regime for ATSs, which permits a broker-dealer to operate an ATS after it files a form notifying the Commission of its intent. Under the proposal, the Commission would have a 120 calendar day period to review a Form ATS-N filing and declare it effective or ineffective. [\[7\]](#) If the Commission declares the filing ineffective, the NMS Stock ATS would be prohibited from operating as an NMS Stock ATS, unless and until it re-files a Form ATS-N that the Commission declares effective. [\[8\]](#)

## **Public Disclosure**

In contrast to the current practice of deeming ATS filings confidential, the proposal would require the Commission to post all effective Forms ATS-N on its website. [\[9\]](#) The proposal also would require each NMS Stock ATS to post on its website a hyperlink to the SEC website that contains its Form ATS-N. [\[10\]](#)

## **Amendments to Form ATS-N**

The Commission proposes to require an NMS Stock ATS to amend its Form ATS-N in the following circumstances:

- At least 30 calendar days prior to the date of implementation of a material change to the operation of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that are subject to disclosure on Form ATS-N;
- Within 30 calendar days after the end of each calendar quarter to correct any other information that has become inaccurate for any reason and has not been previously reported to the Commission as a Form ATS-N Amendment; or
- Promptly, to correct information in any previous disclosure on Form ATS-N, after discovery that any information filed on a Form ATS-N or an amendment was inaccurate or incomplete when filed. [\[11\]](#)

The Commission would post Form ATS-N amendments on its website upon filing. The Commission would review amendments to Forms ATS-N and could declare an amendment ineffective within 30 calendar days, if it finds that doing so would be necessary or appropriate in the public interest, and consistent with the protection of investors. If the Commission declares a Form ATS-N amendment ineffective, the NMS Stock ATS would be prohibited from operating pursuant to the ineffective Form ATS-N amendment.

### **Suspension, Limitation, and Revocation of the Exemption**

The proposal would authorize the Commission, after notice and opportunity for a hearing, to issue an order suspending, limiting, or revoking an NMS Stock ATS's ability to operate for up to 12 months. [12] If the Commission suspends or revokes the exemption for an NMS Stock ATS, that ATS would be prohibited from operating unless it registers as a national securities exchange. If the Commission limits the exemption, the NMS Stock ATS could continue to operate, but would be prohibited from operating in a manner inconsistent with the terms and conditions of the Commission's order.

### **Written Safeguards and Written Procedures to Protect Confidential Trading Information**

Regulation ATS currently requires every ATS to have in place safeguards and procedures to protect subscribers' confidential trading information and to separate ATS functions from other broker-dealer functions, including proprietary and customer trading. The Commission proposes to require ATSs to adopt and maintain these safeguards and procedures in written form.

Jennifer S. Choi  
Associate General Counsel

George M. Gilbert  
Counsel

#### **endnotes**

[1] Regulation of NMS Stock Alternative Trading Systems, Securities Exchange Act Release No. 76474 (Nov. 18, 2015), available at <http://www.sec.gov/rules/proposed/2015/34-76474.pdf> ("Proposing Release").

[2] See Regulation of Exchanges and Alternative Trading Systems, Securities Exchange Act Release No. 40760 (Dec. 8, 1998), available at <http://www.sec.gov/rules/final/34-40760.txt>.

[3] Under the notice registration regime in Regulation ATS, the Commission does not approve or disapprove Form ATS filings.

[4] Proposing Release at 20.

[5] Id. at 20-21.

[6] Id. at 365. ICI has urged the Commission to increase the transparency and standardization of order routing information that institutional investors receive from their brokers. See ICI Memorandum 28480 (October 23, 2015), available at [https://www.ici.org/my\\_ici/memorandum/memo28480](https://www.ici.org/my_ici/memorandum/memo28480).

[7] See Proposed Rule 304(a)(1)(ii) under the Exchange Act. If a Form ATS-N is “unusually lengthy or raises novel or complex issues that require additional time for review,” the Commission could extend the review period by (i) 120 days, in the case of an NMS Stock ATS that is operating as of the effective date of the rule, or 90 days, for all other NMS Stock ATSs or (ii) any extended review period to which a duly-authorized representative of the NMS Stock ATS agrees in writing.

[8] Under the proposal an NMS Stock ATS operating as of the effective date of the proposal would have 120 calendar days from the effective date of the rule to file a Form ATS-N with the Commission. Such an NMS Stock ATS could continue operating pursuant to its previously filed ATS documentation pending the Commission’s review of the Form ATS-N.

[9] See Proposed Rule 304(b)(1)(C) under the Exchange Act.

[10] See Proposed Rule 304(b)(3) under the Exchange Act.

[11] See Proposed Rule 304(a)(2) under the Exchange Act. An NMS Stock ATS also would be required to notice its cessation of operations on Form ATS-N at least 10 business days before the date that the NMS Stock ATS ceases to operate. See Proposed Rule 304(a)(3) under the Exchange Act.

[12] See Proposed Rule 304(a)(4) under the Exchange Act.

---

**Source URL:** <https://icinew-stage.ici.org/memo-29521>

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.