

MEMO# 30050

July 19, 2016

SEC Proposes Rules to Improve Disclosure of Institutional Order Handling Information; Member Call Scheduled for July 28 at 8:30 a.m. (ET)

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TO: EQUITY MARKETS ADVISORY COMMITTEE No. 25-16 RE: SEC PROPOSES RULES TO IMPROVE DISCLOSURE OF INSTITUTIONAL ORDER HANDLING INFORMATION; MEMBER CALL SCHEDULED FOR JULY 28 AT 8:30 A.M. (ET)

The Securities and Exchange Commission (“SEC” or “Commission”) recently proposed rules that for the first time would require broker-dealers to disclose certain information about their handling of institutional orders. [\[1\]](#) This proposal addresses an ICI-led initiative to improve the ability of institutional investors—including funds and their managers—to evaluate broker-dealer routing of institutional orders. The proposed rules also would expand the information included in existing retail order disclosures. Comments on the proposal are due 60 days after its publication in the Federal Register, which is expected soon.

We will hold a 60-minute member call to discuss the proposal on July 28 at 8:30 a.m. (ET). We circulated an Outlook invitation to this call on July 13. If you plan to participate in the call, please respond to that invitation or send an email to Helenia Walker at helenia.walker@ici.org to receive dial-in information.

Background

Funds and other institutional investors currently receive a range of information from their broker-dealers regarding the routing and execution quality of their equity market orders and the potential conflicts of interest that broker-dealers face in handling these orders. Institutional investors have access to publically-available order routing and execution quality statistics pursuant to Rules 605 and 606 of Regulation NMS as well as through ad hoc reports that broker-dealers prepare in response to an investor’s request. Those reports, however, do not provide information to measure the performance of broker-dealers and execution venues with respect to specific institutional investors. In addition, those reports are not presented in a uniform manner that allows for easy comparison across

different broker-dealers and venues.

In 2014, in response to member interest in enhancing the level of transparency around equity market structure in general and execution quality in particular, ICI organized a transparency initiative industry working group. The working group included representatives of investment managers, broker-dealers, exchanges, and other trade associations. The working group developed a standardized disclosure template that each broker-dealer would provide to its institutional clients upon request. This disclosure template would have provided institutional investors with order handling information organized according to the execution venue(s) to which a broker-dealer routed client orders and the algorithm(s) employed by the broker-dealer to execute such orders. ICI and other trade associations recommended that the SEC use this disclosure template as the basis of a rule to provide funds and other institutional investors with a broad range of statistical data regarding a broker-dealer's handling of a specific customer's orders, along with the execution quality achieved by the broker-dealer at each execution venue. [\[2\]](#)

Proposed Disclosures for Institutional Orders

The proposed rules would require broker-dealers to provide customers with standardized information about their institutional order handling and execution quality and to disclose publicly the same information on an aggregated basis across all customers. The Commission believes that the customer-specific disclosures would help customers assess their broker-dealers' services, including the handling of potential conflicts of interest, risks of information leakage, and best execution. According to the Commission, the aggregated public disclosures would assist market participants in assessing and comparing the institutional order handling services provided by broker-dealers.

Customer-Specific Disclosures

The proposal would require a broker-dealer to provide a customer, within seven business days of the request, a report on the broker-dealer's handling of the customer's institutional orders that contains specified monthly data for the previous six months. [\[3\]](#) For purposes of this report, the handling of an institutional order would include the handling of all smaller orders derived from the institutional order. The specific disclosure elements are nearly identical to those included in the template recommended by ICI.

The report would include:

- The number of shares sent to the broker-dealer;
- The total number of shares executed by the broker-dealer as principal; and
- The total number of institutional orders exposed by the broker-dealer through actionable indications of interest and the venue(s) to which they were exposed. [\[4\]](#)

The report also would include the following information for each venue to which the broker-dealer routed institutional orders for the customer, in the aggregate and broken down by passive, neutral, and aggressive order routing strategies as determined and assigned by the broker-dealer: [\[5\]](#)

- Information on order routing [\[6\]](#)
 - Total shares routed;
 - Total shares routed marked immediate or cancel;
 - Total shares routed that were further routable; and
 - Average order size routed;

- Information on order execution [\[7\]](#)
 - Total shares executed;
 - Fill rate (shares executed divided by the shares routed);
 - Average fill size;
 - Average net execution fee or rebate (expressed in cents per 100 shares, specified to four decimal places);
 - Total number of shares executed at the midpoint;
 - Percentage of shares executed at the midpoint;
 - Total number of shares executed that were priced on the side of the spread more favorable to the institutional order;
 - Percentage of total shares executed that were priced on the side of the spread more favorable to the institutional order;
 - Total number of shares executed that were priced on the side of the spread less favorable to the institutional order; and
 - Percentage of total shares executed that were priced on the side of the spread less favorable to the institutional order;
- Information on orders that provided liquidity [\[8\]](#)
 - Total number of shares executed;
 - Percentage of shares executed;
 - Average time between entry and execution or cancellation (in milliseconds); and
 - Average net execution rebate or fee (expressed in cents per 100 shares, specified to four decimal places);
- Information on orders that removed liquidity [\[9\]](#)
 - Total number of shares executed;
 - Percentage of shares executed; and
 - Average net execution fee or rebate (expressed in cents per 100 shares, specified to four decimal places).

Public Aggregated Report on Institutional Order Handling

The proposal would require broker-dealers to make aggregated reports of their handling of institutional orders available publicly on a quarterly basis and to post these aggregated reports on a free, publicly-accessible website for three years. [\[10\]](#)

Retail Order Disclosures

The proposal also would require enhanced disclosures of retail order routing information. Specifically, proposal would require broker-dealers in their quarterly reports on retail order routing information to: [\[11\]](#)

- Differentiate between marketable and non-marketable limit orders;
- Report routing information by calendar month instead of quarterly and no longer report NMS stocks by listing market;
- Post the report on a free, publicly-accessible website for three years;
- Include specified information about the costs and incentives of executing at the venues the broker-dealer routes to most frequently; and
- Include a description of the terms of any payment for order flow and any profit-sharing arrangements that may influence a broker-dealer's order routing decision.

Format of Reports

The proposal would require a broker-dealer to provide required reports using XML and PDF formats as published on the Commission's website, so that the data in the report would be in a consistent, structured format that would facilitate search capabilities and statistical and comparative analyses across broker-dealers and date ranges.

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endnotes

[1] Disclosure of Order Handling Information, Securities Exchange Act Release No. 78309 (Jul. 13, 2016), available at <https://www.sec.gov/rules/proposed/2016/34-78309.pdf> ("Release").

[2] See ICI Memorandum No. 28480 (Oct. 23, 2014), available at https://www.ici.org/my_ici/memorandum/memo28480; Letter from Dorothy M. Donohue, Deputy General Counsel, ICI, Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, and Randy Snook, Executive Vice President, Securities Industry and Financial Markets Association to Mary Jo White, Chair, SEC, dated October 23, 2014, available at <https://www.ici.org/pdf/28480.pdf>.

[3] See Release at 305-306 (proposed Rule 242.606(b)(3)). The proposal would define "institutional order" as "an order to buy or sell an NMS stock that is not for the account of a broker or dealer and is an order for a quantity of an NMS stock having a market value of at least \$200,000." See Release at 301 (proposed Rule 242.600(b)(31)).

[4] An indication of interest would be actionable if it explicitly or implicitly conveys all of the following information: (1) symbol; (2) side (buy or sell); (3) a price that is equal or to or better than the national best bid or offer; and (4) a size that is at least equal to one round lot. See Release at 301 (proposed Rule 242.600(b)(1)).

[5] This proposed requirement would be similar, but not identical to ICI's request that the SEC require broker-dealers to provide data broken down by venue and by trading algorithm. The proposal would define a passive order routing strategy as one that emphasizes the minimization of price impact over the speed of execution. A neutral order routing strategy would be relatively neutral between minimization of price impact and the speed of execution. An aggressive order routing strategy would emphasize the speed of execution over minimization of price impact. See Release at 307-308 (proposed Rule 242.606(b)(3)(v)).

[6] See Release at 306 (proposed Rule 242.606(b)(3)(i)).

[7] See Release at 306-307 (proposed Rule 242.606(b)(3)(ii)).

[8] See Release at 307 (proposed Rule 242.606(b)(iii)).

[9] See Release at 307 (proposed Rule 242.606(b)(iv)).

[\[10\]](#) See Release at 308 (proposed Rule 242.606(c)).

[\[11\]](#) See Release at 303-305 (proposed Rule 242.606(a)(1)).

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