# SEC Staff Issues Responses to Frequently Asked Questions Concerning Amendments to Rule 606 of Regulation NMS

[31911]

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Equity Markets Advisory Committee SUBJECTS: Trading and Markets RE: SEC Staff Issues Responses to Frequently Asked Questions Concerning Amendments to Rule 606 of Regulation NMS

The staff of the SEC's Division of Trading and Markets recently issued responses to frequently asked questions (FAQ) on Rule 606 of Regulation NMS, a rule that requires broker-dealers to make detailed disclosures about their order handling practices.[1] The SEC adopted amendments to Rule 606 of Regulation NMS in November 2018 to modernize and enhance the disclosures required by the rule and to improve the ability of institutional investors (such as registered funds) to evaluate how broker-dealers rout their orders.[2] Specifically, as amended, Rule 606(b)(3) of Regulation NMS requires a broker-dealer, upon request of a customer that places "not held" orders, to provide specific disclosures, for the prior six months, regarding routing and execution of such orders.[3] In addition, Rule 606(a), as amended, requires broker-dealers to make aggregated order routing disclosures for "held" orders publicly available on a quarterly basis.

The FAQ provides technical guidance on 13 issues, including reporting requirements for "white-labelling" arrangements, the treatment of trading venues in order handling reports, and reporting requirements for transaction-based fees and rebates paid or received by broker-dealers. The FAQ also describes several scenarios where a broker-dealer will need to obtain information from a third-party (typically another broker-dealer) to comply with Rule 606 reporting obligations.

The FAQ addresses the following questions:

## Section 1: Not Held NMS Stock Order Reports Under Rule 606(b)(3)

**Issue 1: Order Handling and Routing Arrangements (including cases involving the**

**use of another broker-dealer's execution services including "white labeling" arrangements)**

- Question 1.01: Broker-Dealer A has a "white-labeling" arrangement with Broker-Dealer B, in which Broker-Dealer A routes and executes orders that it receives from its customers using execution services that it licenses or outsources from Broker-Dealer B. Is Broker-Dealer A required to provide the Rule 606(b)(3) report with regard to venues to which it routed orders using the execution services that it white-labeled from Broker-Dealer B ?

- Question 1.02: Broker-Dealer A receives orders from its customer and those orders are routed to Broker-Dealer C using an execution service from Broker-Dealer B over which Broker-Dealer A exercises discretion. Broker-Dealer C then further routes to other venues child orders derived from the orders it received from Broker-Dealer A. Is Broker-Dealer A required to provide the Rule 606(b)(3) report with regard to the other venues to which Broker-Dealer C routed child orders?

- Question 1.03: Broker-Dealer A routes its customer's orders to Broker-Dealer B, subject to an arrangement where Broker-Dealer A has chosen a cost-plus fee structure and specified a desire to route orders in a manner that may maximize rebates and minimize transaction fees to the extent practicable. Is Broker-Dealer A required to provide the Rule 606(b)(3) report with regard to venues to which Broker-Dealer B routed orders?

- Question 1.04: Broker-Dealer A and Broker-Dealer B have a generally established course of dealing where Broker-Dealer A expects Broker-Dealer B to modify or utilize a certain pre-set configuration in its routing strategy in terms of urgency (*e.g.*, passive vs. aggressive) when taking liquidity, or expects Broker-Dealer B never to route a child order to a particular venue. Broker-Dealer A routes its customer's orders to Broker-Dealer B with general instructions to use Broker-Dealer B's execution services but no further explicit qualifications, parameters, or instructions are provided at the time the orders are routed. Is Broker-Dealer A required to provide the Rule 606(b)(3) report with regard to venues to which Broker-Dealer B routed orders?

- Question 1.05: Broker-Dealer A receives orders from its customer and routes those orders to Broker-Dealer B using Broker-Dealer B's execution services for further handling. When Broker-Dealer A routes orders to Broker-Dealer B, Broker-Dealer A instructs Broker-Dealer B to handle them with a certain level of urgency (*e.g.* passively or aggressively) but otherwise leaves the order handling and routing decisions to Broker-Dealer B. Is Broker-Dealer A required to provide the Rule 606(b)(3) report with regard to venues to which Broker-Dealer B routed orders?

- Question 1.06: Broker-Dealer A routes its customer's orders to Broker-Dealer B for further handling and instructs Broker-Dealer B to interact only with "lit" venues when handling the orders. Is Broker-Dealer A required to provide the Rule 606(b)(3) report with regard to venues to which Broker-Dealer B routed orders?

- Question 1.07: Broker-Dealer A receives a large order from its customer. As part of its handling of the customer's order, Broker-Dealer A routes a directed order to Broker-Dealer B and relies on Broker-Dealer B to determine the timing and whether Broker-Dealer B will break the large order into child orders (as well as the size of any child orders) to be routed to the specified venue. Is Broker-Dealer A required to provide the Rule 606(b)(3) report with regard to the venue to which Broker-Dealer B routed?

**Issue 2: Venues**

- Question 2.01: Is there a difference between a "venue" for purposes of the customer-

specific reports required by Rule 606(b)(3) for not held orders versus a "venue" for purposes of the public quarterly reports required by Rule 606(a) for held orders and options orders?

- Question 2.02: What can be a venue for Rule 606(b)(3) reporting purposes?
- Question 2.03: Can the customer-facing broker-dealer be a venue for Rule 606(b)(3) reporting purposes if it executes some or all of its customer's order internally?
- Question 2.04: A customer submits orders to Broker-Dealer A, which then routes the orders to Broker-Dealers B, C, and D. Broker-Dealer A exercises discretion regarding how Broker-Dealers B, C, and D further route the orders. Broker-Dealers B, C, and D further route to Exchanges X and Y child orders derived from the orders that they received from Broker-Dealer A, and Broker-Dealers B and C (but not Broker-Dealer D) also execute internally some portion of the orders that Broker-Dealer A routed to them. Broker-Dealer B's internal executions occur in an ATS that it operates and Broker-Dealer C's internal executions occur in a single-dealer execution platform that it operates. What venues should be included in Broker-Dealer A's Rule 606(b)(3) report to its customer?
- Question 2.05: Broker-Dealer A has an arrangement with Broker-Dealer B, in which Broker-Dealer A routes and executes orders that it receives from its customers using execution services that it licenses or outsources from Broker-Dealer B. A customer submits several large orders to Broker-Dealer A and, using the execution services that it licenses or outsources from Broker-Dealer B, Broker-Dealer A routes and executes the order in discrete portions across the following range of venues: (i) an ATS operated by Broker-Dealer B, (ii) an internal execution desk at Broker-Dealer C, and (iii) Exchange D. What venues should be included in Broker-Dealer A's Rule 606(b)(3) report to its customer?

## Issue 3: Average Time Between Order Entry and Execution or Cancellation for Orders Providing Liquidity

- Question 3.01: Does the Rule 606(b)(3)(iii)(C) requirement that broker-dealers disclose the average time between order entry and execution or cancellation for orders providing liquidity (in milliseconds) apply only to orders that are joining or improving the NBBO at time of entry?
- Question 3.02: How should a broker-dealer measure the average time between order entry and execution or cancellation when an order is partially filled and the remainder is subsequently cancelled?
- Question 3.03: How should a broker-dealer report the average time between order entry and execution when an order is fully filled by multiple executions?

## Issue 4: Information on Orders that Provided or Removed Liquidity

- Question 4.01: Under Rule 606(b)(3)(iii)-(iv), a broker-dealer must disclose information on its customer's orders that provided or removed liquidity. Do all orders either provide or remove liquidity when executed?

## Issue 5: Fees and Rebates

- Question 5.01: How should a broker-dealer comply with the requirement under Rule 606(b)(3) to report to its customer average net execution fee or rebate information when the fee or rebate information is not known at the time of the customer request (*e.g.*, delay in receipt of fee or rebate information due to volume threshold pricing tiers)?

- Question 5.02: How should an average net execution fee be distinguished from an average net execution rebate in the Rule 606(b)(3) report?
- Question 5.03: In a scenario in which Broker-Dealer A routes its customer's orders to Broker-Dealer B for further handling, and Broker-Dealer B does not execute internally any portion of the orders received from Broker-Dealer A but routes the orders to Exchanges X and Y for execution, how should any payments between Broker-Dealers A and B be reported on Broker-Dealer A's Rule 606(b)(3) report to its customer, assuming that Broker-Dealer A exercised discretion over Broker-Dealer B's routing?

## Issue 6: Average Price Accounts and Aggregated Orders

- Question 6.01: How could broker-dealers disclose the information required by Rule 606(b)(3) in a scenario where an introducing broker aggregates various customers' orders into one large order that is routed to an executing broker for further order handling (*e.g.*, using an average price account)?

## Issue 7: Orders That Are Further Routable

- Question 7.01: For the purposes of Rule 606(b)(3), how could broker-dealers determine whether an order is further routable?

## Issue 8: Actionable Indications of Interest ("IOIs")

- Question 8.01: Broker-Dealer A sends an IOI to Broker-Dealer B, an external liquidity provider, in which Broker-Dealer A specifies that it would like to purchase 10,000 shares of a particular NMS stock, but does not specify a limit price. Through a generally established course of dealing, Broker-Dealer B knows that Broker-Dealer A is willing to cross the spread when purchasing NMS stock. Is the IOI an actionable IOI and thus subject to reporting under Rule 606(b)(3)?

## Issue 9: Riskless Principal Transactions

- Question 9.01: Rule 606(b)(3) requires a broker-dealer to report, among other things, the total number of shares of a customer's order flow that the broker-dealer executed as principal for its own account. Should the broker-dealer include riskless principal transactions in the customer's report pursuant to this requirement?

## Issue 10: De Minimis Exceptions

- Question 10.01: May a broker-dealer avail itself of the Rule 606(b)(4) de minimis exception from providing customer-specific disclosures under Rule 606(b)(3) for a particular branch of the broker-dealer if the branch does not handle any not held order flow?

# Section 2: NMS Stock Held Order and Options Order Reports Under Rule 606(a)

## Issue 11: Limit Orders – Marketable vs. Non-marketable

- Question 11.01: For purposes of complying with the requirements of Rule 606(a), may a broker-dealer determine whether a limit order is marketable or non-marketable at the time the broker-dealer routes the order to a venue for execution?
- Question 11.02: For purposes of Rule 606(a)(1)'s requirement that broker-dealers

differentiate non-directed orders that are marketable limit orders from non-directed orders that are non-marketable limit orders, is marketability assessed at the parent order level or the child order level?

- Question 11.03: How could marketability be determined for orders placed outside of regular market hours?

## Issue 12: Fees and Rebates

- Question 12.01: A customer sends a NMS stock order to Broker-Dealer A, which then routes the order to Broker-Dealer B, a routing broker-dealer that does not execute orders but provides execution services. Broker-Dealer B routes child orders to and receives executions from multiple venues with associated fees/rebates. For purposes of quarterly reporting under Rule 606(a)(1), how could Broker-Dealer A report fees or rebates between Broker-Dealer B and the execution venues and report fees or rebates between Broker-Dealer A and Broker-Dealer B?
- Question 12.02: Many execution venues offer tiered pricing arrangements where the volume or type of order flow sent to the venue by a broker-dealer determines the applicable pricing. For example, some venues may offer incrementally higher rebates or lower fees to broker-dealers for additional order flow volume. Or, as another example, venues may offer different pricing tiers for marketable order flow versus non-marketable order flow. How should such tiered pricing arrangements be disclosed under Rule 606(a)(1)?

## Issue 13: Options Orders Report

- Question 13.01: When a retail options broker routes customer options orders to a consolidator which then sends those orders to an options exchange for execution, does the retail options broker have a reporting responsibility under Rule 606(a) and, if so, what is it?
- Question 13.02: How are complex options orders disclosed under Rule 606(a)?

Question 13.03: Rule 606(a)(1)(iii) requires any broker-dealer to disclose the "net aggregate amount of any payment for order flow received" for its customers' options orders. The XML schema that Rule 606(a)(1) requires for the disclosure format describes the unit of measurement for this data as "Net Cents Per Hundred Shares." How would this unit apply to the disclosure of options orders?

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**endnotes**

[1] *See* Responses to Frequently Asked Questions Concerning Rule 606 of Regulation NMS (August 16, 2019), *available at* https://www.sec.gov/tm/faq-rule-606-regulation-nms.

[2] For a summary of the rule, *see* ICI Memorandum No. 31488 (November 19, 2018), *available at* https://www.ici.org/my_ici/memorandum/memo31488.

[3] A "not held" order typically is a customer order that provides the broker-dealer with

discretion over how to handle the order, particularly with respect to the price and time of execution. A "held" orders, in contrast, typically is a customer order that a broker-dealer must attempt to execute immediately.

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