

MEMO# 34028

February 8, 2022

SEC Re-Proposes US Government Securities ATS Rule and Amendments to Exchange Definition

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TO: Equity Markets Advisory Committee
Fixed-Income Advisory Committee RE: SEC Re-Proposes US Government Securities ATS Rule and Amendments to Exchange Definition

On January 26, the SEC re-proposed its 2020 amendments to Regulation ATS to require an alternative trading system (ATS) that trades government securities or repos and reverse repos on government securities ("Government Securities ATS") to comply with Regulation ATS and Regulation SCI.[\[1\]](#) Based on public comment on the concept release in the original proposal, the re-proposal also includes a revised regulatory definition of "exchange" that would apply Regulation ATS to additional types of trading platforms and communication protocols. Further, the re-proposal would revise Form ATS-N, which is currently filed by NMS Stock ATSs and discloses information about the activities of an ATS's broker-dealer operator and how an ATS operates. We summarize aspects of the re-proposal that may be of interest to members below.

Comments are due 30 days after publication of the re-proposal in the Federal Register. We will hold a Zoom member call on **Monday, February 14 at 3:00 p.m. (ET)** to discuss the re-proposal.

Background

In the September 2020 proposal, the SEC proposed to eliminate the exemption from Regulation ATS for a Government Securities ATS and require compliance with several ATS requirements, including broker-dealer registration, protection of subscriber confidential trading information, and separation of ATS functions from other broker-dealer functions.[\[2\]](#) A Government Securities ATS would also become subject to the Fair Access Rule[\[3\]](#) if it had 5% or more of the average weekly dollar volume traded in the US for US Treasuries and agency securities, respectively. Further, a Government Securities ATS would be required to file a new public Form ATS-G that provides information about how it operates.

The SEC included in the proposal a concept release requesting comment on whether to regulate fixed income electronic platforms that trade corporate debt and municipal

securities. Among its questions, the SEC asked whether it should adapt the regulatory definition of "exchange" to capture certain unregulated platforms, such as request-for-quote ("RFQ") protocols that are commonly used by market participants in the dealer-to-customer market. The SEC sought this feedback to evaluate whether regulatory gaps currently exist among different fixed income trading platforms that it should address.

ICI submitted a comment letter expressing support for registering Government Securities ATSs, stating that applying ATS and SCI rules would promote operational transparency, investor protection, fair access, and system security and resiliency.^[4] To preserve trading flexibility and allow for more time to study electronic trading in fixed income markets, however, ICI recommended that the Commission not impose the exchange/ATS framework on electronic trading protocols and functionalities in these markets that do not meet the existing definition of an ATS or an exchange.

Expansion of "Exchange" Definition

The SEC proposes to broaden the definition of "exchange" under Rule 3b-16(a) of the Exchange Act to mean an organization, association, or group of persons that (i) brings together buyers and sellers of securities using "trading interest"^[5] on a bilateral or multilateral basis; and (ii) makes available established, non-discretionary methods (whether by providing a trading facility or "communication protocols,"^[6] or by setting rules) through which they can interact and agree to a trade. While such systems would be deemed as exchanges, they would be able to operate as an ATS that is exempt from exchange regulations by meeting conditions such as registering as a broker-dealer.^[7] The SEC emphasizes that the definition would also apply to trading systems for any security, including government securities and NMS stocks.^[8] In the SEC's view, expanding the definition would address the competitive imbalance between registered exchanges/ATSs and unregulated systems, among other benefits.

The re-proposal provides examples of the types of systems that would qualify as an "exchange." The definition would specifically capture "communication protocol systems" such as RFQ systems, streaming axes, conditional order protocols, and negotiation systems that "scrape" information from a participant's order management or execution management system to alert other participants of trading interest. In the case of RFQ systems, the SEC emphasizes that the exchange definition applies because they provide the ability of more than one buyer to request quotes from more than one seller at the same or different times.^[9] However, the amended definition would still exclude (i) traditional broker-dealer activities, including single-dealer pages; (ii) bulletin boards; and (iii) web chat providers that allow market participants to communicate but do not offer trading protocols. Further, the SEC proposes to specifically exclude issuer systems that allow an issuer to sell its own securities to investors.

Government Securities ATS Registration

The re-proposal would continue to require a Government Securities ATS to register as an ATS, but includes certain heightened requirements:

- Communication protocol systems (e.g., RFQ systems) would meet the "exchange" definition and, thus, would become subject to Regulation ATS along with electronic interdealer trading platforms.
- To enhance disclosure of its operations, a Government Securities ATS would be required to file a more extensive Form ATS-N, which currently applies to NMS Stock ATSs, rather than a separate Form ATS-G as originally proposed.

- A Government Securities ATS would be subject to the Fair Access Rule based on a lower volume threshold than originally proposed, i.e., it had 3% or more of the US Treasury securities average weekly dollar volume traded in the United States during at least four of the preceding six calendar months.[\[10\]](#) The 5% trading volume threshold for agency securities, however, would remain the same.

Amendments to Form ATS-N

The re-proposal would revise existing Form ATS-N to reorganize information responses and include additional information disclosures, such as disclosures that account for Government Securities ATS operations and communication protocol systems. An NMS Stock ATS that has already filed a current Form ATS-N, however, would also be required to submit a revised form no later than 30 days after the end of an applicable quarter.[\[11\]](#) For Government Securities ATSs and other new ATSs (that are communication protocol systems) that must file an initial Form ATS-N, the SEC would have an initial period of 180 calendar days to review the filing, with the ability to extend that period for an additional 120 calendar days.

With respect to disclosures of the trading activities of the broker-dealer and its affiliates (Part II), the revised Form ATS-N would additionally require (i) a description of the circumstances when the broker-dealer operator or its affiliate would be a counterparty to a trade on the ATS; (ii) a list of the broker-dealer operator's business units or affiliates that enter or direct the entry of trading interest into the ATS;[\[12\]](#) and (iii) information on order hedging or aggregation functionalities and post-trade processing offered by the broker-dealer operator or its affiliates.

With respect to the manner of operations (Part III), the revised Form ATS-N would require disclosure of, among other types of information:

- new categories of ATS subscribers;
- ATS rules on how orders interact with non-firm trading interest or separate functionalities that are within the ATS or that are offered by the broker-dealer operator;
- the use of non-firm trading interest and communication protocols on the ATS;
- ATS protocols for supervising and monitoring trading activity;
- functionalities, procedures or protocols that facilitate interaction between the ATS and related markets (e.g., futures, options, currencies, swap, fixed income);
- identities of liquidity providers and their arrangements with the ATS;
- when and how trading interest is segmented and whether the ATS can control the trading interest that a subscriber can interact with, or whether the ATS subscriber itself can exercise such control;
- whether the ATS identifies trading interest entered by a customer of a broker-dealer in the ATS as "customer trading interest";[\[13\]](#)
- how the ATS or its subscribers display trading interest to others on the platform;
- whether a fee is incorporated into the displayed price of a security;
- arrangements with the ATS related to post-trade processing; and
- whether the ATS has triggered the Fair Access Rule volume thresholds.[\[14\]](#)

Fee Amendment Filings to Form ATS-N

The re-proposal includes a new amendment type that applies to ATS fee changes under Form ATS-N. The SEC acknowledges that NMS Stock ATSs have taken different approaches to the timing with which they submit fee changes—while some have treated them as "material changes" that were filed 30 days prior to implementation, others have filed updating amendments within 30 days after the end of the calendar quarter in which the fee

change was already implemented. Thus, the SEC proposes to require that ATSs file a fee amendment no later than the date it makes a change to a fee or fee disclosure. The SEC believes that this would provide the public with sufficient notice about a fee change, while also allowing the ATS to "act nimbly" to make fee changes to respond to competitive pressures from other trading venues.^[15]

Amendments to Fair Access Rule

The re-proposal includes several amendments to the Fair Access Rule. Notably, the SEC proposes to amend the Fair Access Rule to clarify that an ATS must establish and apply "reasonable" written standards for granting, limiting, and denying access to its services.^[16] While the rule would allow for an ATS to differentiate how it treats different subscribers, the SEC specifies that the ATS's written standards that permit such treatment must be fair and not unreasonably discriminatory.^[17] Examples of ATS standards include conditions of access to the ATS based on a subscriber's financial condition, varying scope and level of service offerings among subscribers, and/or differing fee levels. The SEC also emphasizes that fair access requirements apply not only to the initial grant or denial of access to the ATS, but also to the provision of ATS services to subscribers.

The SEC also proposes to eliminate an exclusion from the Fair Access Rule (and Regulation SCI) that applies to "passive" ATSs that trade equities. Currently, an ATS is excluded from compliance if (i) the ATS matches customer orders with other customer orders; (ii) the customers' orders are not displayed to any person; and (iii) such orders are executed at a price disseminated by an equity data reporting plan. The SEC believes that eliminating this exclusion is appropriate based on the belief that activity on passive ATSs is now significant and have become important for matching buyers and sellers.

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endnotes

^[1] Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange"; Regulation ATS for ATSs That Trade US Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSs that Trade US Treasury Securities and Agency Securities ("Re-Proposal") (Jan. 26, 2022), available at <https://www.sec.gov/rules/proposed/2022/34-94062.pdf>.

^[2] Currently, Government Securities ATSs that limit their trading activity to government securities or repos and reverse repos are neither required to register as an exchange under Section 5 of the Exchange Act nor required to comply with Regulation ATS, which specifies conditions to be exempt from exchange registration. Further, an ATS that trades both government securities and other fixed income securities, e.g., corporate bonds or municipal securities, are not fully subject to certain provisions such as the Fair Access Rule, which does not apply to government securities trading.

^[3] The Fair Access Rule requires an ATS to adopt trading system access standards that are applied fairly and prohibit an unreasonable trading prohibition or limitation on any person. SEC Rule 301(b)(5).

^[4] <https://www.ici.org/system/files/attachments/33146a.pdf>.

^[5] "Trading interest" is defined as an "order [as defined under Rule 3b-16(c)] or any non-

firm indication of a willingness to buy or sell a security that identifies at least the security and either quantity, direction (buy or sell), or price." Proposed Rule 300(q). Such indications could be transmitted on either a bilateral or multilateral basis.

[6] The SEC does not specifically define "communication protocols," but states that such protocols generally use non-firm trading interest, rather than orders, to prompt and guide buyers and sellers to communicate, negotiate, and agree to the terms of the trade. This would include, for example, a chat function that sets certain information and parameters for communicating about a potential transaction. See Re-Proposal at 43-44.

[7] Rule 3a1-1(a)(2) exempts "an organization, association or group of persons" that complies with Regulation ATS from the definition of an "exchange" under Section 3(a)(1) of the Exchange Act.

[8] The SEC lists, among other securities: government securities, corporate bonds, municipal securities, NMS stocks, non-NMS stocks, private restricted securities, repo and reverse repo agreements, foreign sovereign debit, and options.

[9] As part of the revised definition of "exchange," the SEC proposes to eliminate the term "multiple," which it believes could be misconstrued to exclude RFQ systems because a RFQ typically involves one buyer and multiple sellers or vice versa. Re-Proposal at 38.

[10] The thresholds for applying the Fair Access Rule would be applied categorically for government securities, rather than on a security-by-security basis.

[11] An NMS Stock ATS, for example, would need to specify whether it makes all NMS stocks available for trading and, if not, those that are not made available. See Part I.8 of Revised Form ATS-N.

[12] For example, the SEC specifies that if an affiliated asset manager of the broker-dealer operator uses the services of a third-party broker-dealer to direct trading interest to the ATS, i.e., the asset manager instructs the third-party broker-dealer to send its trading interest to the ATS, then the ATS would be required to list that affiliated asset manager. Re-Proposal at 187.

[13] According to the SEC, disclosing the origin of customer trading interest of a broker-dealer could constitute segmentation because it could contribute to information leakage and adverse selection of institutional investors' trading interest, who generally trade passively. Re-Proposal at 256.

[14] The re-proposal would require aggregation of trading volumes across ATSs operated by a common broker-dealer or by affiliated broker-dealers to determine the applicability of the Fair Access Rule to their operations, i.e., whether they meet the trading volume thresholds.

[15] Re-Proposal at 153.

[16] Proposed Rule 301(b)(5).

[17] The proposed amendments also set forth several minimum requirements for an ATS's written standards: (i) the ATS must provide the dates that each written standard is adopted, effective, and modified; (ii) the standards must set forth any objective and quantitative criteria upon which they are based; (iii) the standards must identify any differences in access to the ATS's services by applicants and current participants; (iv) the standards as

written must justify why each standard, including differences in access to the ATS's services, is fair and not unreasonably discriminatory; and (v) the standards must address the granting, limiting, or denying access to the ATS's services that are performed by persons other than the broker-dealer operator. Proposed Rule 301(b)(5)(iii)(A)(1)-(5).

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