

MEMO# 35154

March 10, 2023

Your Comments Requested by COB March 17: ICI Draft Letter on Regulation Best Execution and the Order Competition Proposals

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TO: Closed-End Investment Company Committee
Equity Markets Advisory Committee
ETF (Exchange-Traded Funds) Committee
Fixed-Income Advisory Committee
Municipal Securities Advisory Committee
SEC Rules Committee
Security Valuation Operations Committee RE: Your Comments Requested by COB March 17:
ICI Draft Letter on Regulation Best Execution and the Order Competition Proposals

ICI is circulating the draft comment letter regarding the Securities and Exchange Commission's (the "Commission" or SEC) proposals for Regulation Best Execution^[1] and the Order Competition Rule,^[2] both of which were proposed on December 14, 2022. A separate comment letter on the SEC's Tick Size and Access Fee Reduction Proposal^[3] was circulated yesterday.

Comments are due to the SEC on these proposals by Friday, March 31. The draft letter includes several areas where ICI seeks additional member feedback. Please review these questions and provide your written feedback accordingly.

To ensure that we have sufficient time to incorporate or address any further member comments and views before the 31st, please provide me with any feedback or comments by email at kevin.ercoline@ici.org no later than COB Friday, March 17.

While the ICI supports efforts to enhance execution quality and market integrity, we have concerns with how certain terms in proposed Regulation Best Execution and the Order Competition Rule are defined and the potential negative impact on members' order handling and the resulting execution quality for advisory clients. Additionally, ICI is concerned about the potential lack of coordination by the SEC with FINRA, MSRB, and the exchanges (SROs) with regard to establishing a consistent best execution standard as well

as any SRO rulemakings needed to implement such finalized best execution standard. Further, while ICI supports greater opportunities for institutional investors to execute against retail order flow, we question certain of the underlying assumptions of the proposed Order Competition Rule and whether the auctions, as proposed, will operate as intended and increase interaction of institutional and retail order flow. Finally, we are concerned about the lack of compliance sequencing of not only the Regulation Best Execution and Order Competition Rule proposals but, more broadly, the lack of sequencing of all four of the market structure proposals the SEC recently issued (collectively, the "Market Structure Proposals"), as each proposal has significant implications individually and for one another.

To address these concerns, we make the following recommendations:

- First, we recommend that the SEC revise its proposed definitions of "transaction for or with a retail customer" and "segmented order" in Regulation Best Execution and the Order Competition Rule, respectively, to reflect existing FINRA and exchange definitions of "retail order." These existing definitions recognize that an order should be treated as a "retail order" based on who is submitting the order rather than who the ultimate account holder is. Registered investment advisers often submit orders on behalf of discretionary advisory accounts, which may be for natural persons, to broker-dealers on an aggregated or "bunched" basis to obtain better average price execution for investors. If orders from some discretionary advisory accounts are considered "transactions for or with a retail customer" or "segmented orders," advisers may no longer be able to bunch all discretionary advisory account orders together as some orders will likely be subject to separate order handling procedures and compliance requirements due to the "conflicted transaction" provisions of Regulation Best Execution and the auction routing provisions of the Order Competition Rule. We urge the Commission to adopt our recommended changes to its proposed definitions to permit continuation of well-accepted bunching practices, which benefit investors.
- Second, we recommend that the SEC adopt a best execution standard that is consistent with SRO standards and coordinate closely with the SROs regarding implementation. ICI specifically recommends that the SEC should: 1) incorporate into its best execution standard the factors included in FINRA's best execution standard, and 2) coordinate with the SROs to adopt a trade modifier indicating whether an order is a "retail" order. ICI is concerned that, as drafted, the SEC's proposed best execution standard may result in an inappropriately singular focus on price when considering best execution without adequately weighing other factors critical for large, institutional orders. Further, without a trade modifier, ICI is concerned about the inefficient and costly order handling practices that our members likely would experience due to non-originating brokers being unable to determine whether our members' orders are institutional orders or retail orders subject to the "conflicted transaction" provisions of Regulation Best Execution.
- Third, while ICI and its members appreciate increased opportunities for institutional investors to interact with retail order flow, we question some of the key assumptions underlying the auction mechanism in the proposed Order Competition Rule and, as a result, whether the auctions would operate as proposed or be effective. We recommend that the SEC re-evaluate its assumptions and potentially take a simpler approach.
- Fourth, we recommend that the SEC perform an economic analysis that acknowledges

the critical interplay among the Market Structure Proposals. Further, we recommend that the SEC propose a multi-year, phased implementation schedule that acknowledges the interconnected compliance implementation efforts that will be required for all the Market Structure Proposals. It is unknown how reduced tick sizes, associated harmonization, and the auctions will affect liquidity and order flow. If all four Market Structure Proposals have similar compliance dates, it will be impossible for our members to assess whether they are receiving best execution from brokers for client orders, as it will be premature to determine the impact on best execution until the other Market Structure Proposals are implemented.

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Notes

[1] Regulation Best Execution, Securities Exchange Act Release No. 96496, 88 Fed. Reg. 5440 (Jan. 27, 2023), available at <https://www.govinfo.gov/content/pkg/FR-2023-01-27/pdf/2022-27644.pdf>.

[2] Order Competition Rule, Securities Exchange Act Release No. 96495, 88 Fed. Reg. 128 (Jan. 3, 2023), available at <https://www.govinfo.gov/content/pkg/FR-2023-01-03/pdf/2022-27617.pdf>.

[3] Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, Securities Exchange Act Release No. 96494, 87 Fed. Reg. 80266 (Dec. 29, 2022), available at <https://www.govinfo.gov/content/pkg/FR-2022-12-29/pdf/2022-27616.pdf>.

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