

MEMO# 35227

March 31, 2023

ICI Files Comment Letter with SEC on Regulation Best Execution and Order Competition Rule Proposals

[35227]

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TO: ICI Members

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 SUBJECTS: Closed-End Funds

Compliance

Exchange-Traded Funds (ETFs)

Fixed Income Securities

Investment Advisers

Municipal Securities

Operations

Trading and Markets RE: ICI Files Comment Letter with SEC on Regulation Best Execution and Order Competition Rule Proposals

On March 31, 2023, ICI filed a comment letter on the SEC's proposals for Regulation Best Execution[\[1\]](#) and the Order Competition Rule[\[2\]](#) issued by the SEC on December 14, 2022. Proposed Regulation Best Execution would establish a new SEC-level standard regarding a broker-dealer's duty of best execution with new compliance and recordkeeping obligations as well as additional obligations with respect to "conflicted transactions" for or with retail customers. The SEC's proposed Order Competition Rule would add a new rule, proposed Rule 615, to Regulation NMS that would prohibit "restricted competition trading centers," such as wholesalers, from internally executing segmented orders for NMS securities until after a broker-dealer exposes the order to competition in an auction, unless an exception applies.

While the ICI did not explicitly oppose or support either proposal, our letter did note several concerns raised by the proposals and provided recommended amendments to reduce the

impact on our members. We stated that our members seek to ensure that broker-dealers are providing best execution with respect to their clients' orders and our belief that FINRA and MSRB's best execution rules, and related notices and guidance combined with the SEC's enforcement efforts, have proved effective in protecting investors. However, if the SEC were to move forward with adopting the proposals, ICI has concerns with how certain terms in proposed Regulation Best Execution, as well as in the Order Competition Rule, are defined and the potential negative impact on members' order handling and 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, with regard solely to the proposed Order Competition Rule, while ICI supports greater opportunities for institutional investors to execute against retail order flow, we question certain of the underlying assumptions of that proposal and whether the auctions, as proposed, will operate as intended and increase interaction of institutional and retail order flow. Finally, we have an overarching concern about the lack of implementation 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").[\[3\]](#)

To address these concerns, ICI's letter makes the following recommendations:

- First, if the SEC moves forward with adopting Regulation Best Execution and the Order Competition Rule, we recommend that the SEC revise its proposed definitions of "transaction for or with a retail customer" and "segmented order" in the respective proposals 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 include accounts for natural persons or institutions (e.g., endowments or foundations), 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 aggregate 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 SEC to adopt our recommended changes to its proposed definitions to permit continuation of well-accepted order aggregation practices, which benefit investors.
- Second, if the SEC decides to adopt its own best execution standard, 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 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, with regard to the proposed Order Competition Rule, 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 proposal and, as a result, whether the auctions would operate as proposed or be effective. We recommend that the SEC re-evaluate its assumptions and 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 as well as other proposed and final market structure rulemakings the SEC has recently issued. Regarding the Market Structure Proposals specifically, it is important that the proposals be implemented, if adopted, in a sequenced manner. For example, it is unknown how reduced tick sizes 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 all the Market Structure Proposals are fully 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] The other two market structure proposals the SEC recently issued are: 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>; Disclosure of Order Execution Information, Securities Exchange Act Release No. 96493, 88 Fed. Reg. 3786 (Jan. 20, 2023), available at <https://www.govinfo.gov/content/pkg/FR-2023-01-20/pdf/2022-27614.pdf>.

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