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KCG

October 31, 2016

Via Electronic Mail

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Disclosure of Order Handling Information
File No. S7-14-16

Dear Mr. Fields:

KCG Holdings, Inc. ("KCG")[1] appreciates the opportunity to submit comments to the Securities and Exchange Commission ("SEC" or "Commission") on its proposal to amend Rules 600 and 606 of Regulation NMS to require broker-dealers to provide additional disclosures to customers about the routing of their orders (the "Proposal").[2]

KCG supports the Proposal's fundamental objective of revamping the order handling disclosure requirements in light of the considerable changes to U.S. equity markets since implementation of the requirements. We agree with the concept of enhancing transparency around order routing for retail customers and we support the goal of making a standardized baseline of more granular order handling information available for all institutional customers. Requiring all broker-dealers to supply institutional

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[1] KCG is a leading independent securities firm offering investors a range of services designed to address trading needs across asset classes, product types and time zones. As an electronic market maker, KCG commits its capital to facilitate trades by buyers and sellers on exchanges, ATSs, and directly with clients. We combine advanced technology with exceptional client service to deliver greater liquidity, lower transaction costs, improve pricing, and provide execution choices. KCG has multiple access points to trade global equities, fixed income, currencies and commodities through voice or automated execution.

[2] Securities Exchange Act Release No. 78309 (July 13, 2016) 81 FR 49432 (July 27, 2016) (the "Proposing Release").

customers with standardized information on execution quality and order routing will ensure the availability of order handling information that today only certain broker-dealers voluntarily provide to their institutional customers. Although we strongly support the policy goals underlying the Proposal, we believe certain modifications are necessary to ensure the proposed rule amendments actually achieve the Proposal's objectives and supply institutional investors with meaningful order handling transparency.

I. Executive Summary

We recommend the following modifications to the Proposal:

- The final rule should differentiate between retail and institutional disclosures based on the manner of treatment of the order – held for retail orders and not-held for institutional orders - as opposed to focusing on notional order amount;
- Broker-dealer should not be required to classify order routing strategies as passive, neutral, or aggressive as this proposed requirement is subjective and will not be comparable across multiple broker-dealers; and
- The Commission should lever the FIX Protocol as an existing institutional disclosure infrastructure instead of establishing an entirely separate disclosure regime.

Our recommendations are discussed in greater detail below.

II. KCG Transparency Initiatives

As a steady proponent of more transparent markets, KCG has consistently practiced what we preach by providing our customers - and the public - with greater levels of order handling disclosure information than otherwise required by regulations. For example, with respect to retail investors, KCG is one of a handful of firms who voluntary publish standardized statistics that provide the retail community with greater visibility into execution quality measures.[3] Regarding institutional investors, KCG voluntary publishes

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[3] KCG and several other firms (*i.e.,* Charles Schwab, Fidelity Investments, Scottrade, Citadel Securities LLC, Two Sigma Securities LLC, and UBS Securities) participated in an initiative led by the Financial Information Forum ("FIF") to create a report template containing supplemental retail execution quality statistics beyond those required by Rules 605 and 606 ("Supplemental Retail Execution

Rule 606 reports for institutional orders notwithstanding the fact that such orders are not covered by existing Rule 606.[4] In addition, KCG MatchIt ATS voluntarily publishes a wealth of documents and information relating to its operations and systems functionality, including its Form ATS.[5] Given our proven commitment to market transparency, KCG welcomes thoughtful revisions to Rules 600 and 606 that would mandate similar levels of openness by all broker-dealers with respect to their handling of customer orders.

III. Discussion of Proposed Modifications

a. Distinguishing between retail and institutional orders

The Proposal calls for broker-dealers to provide differing levels of order handling disclosures based upon whether the orders sent by customers are considered retail or institutional. Customers sending retail orders would essentially receive a certain basic level of disclosures and those submitting institutional orders would be provided more granular order handling information. To that end, the Proposal would use a monetary threshold to determine whether an order would be considered retail or institutional; an institutional order would be defined as an order to buy or sell NMS stock having a market value of at least $200,000 and a retail order would have a market value of less than $200,000.

Quality Report"). KCG produces its Supplemental Retail Execution Quality Report on a quarterly basis along with a set of defined terms and FAQs explaining the meaning of each metric in the report. KCG's Supplemental Retail Execution Quality Reports can be found at https://www.kcg.com/access-performance/execution-quality/.

[4] KCG's Rule 606 Reports for institutional orders can be found at https://www.kcg.com/access-performance/execution-quality/.

[5] KCG MatchIt ATS voluntarily posts to KCG's public website the following documents: MatchIt Form ATS, MatchIt FIX Specifications, MatchIt Frequently Asked Questions, MatchIt Execution Protocols, and a Client Electronic Access and Trading Agreement. These documents can be found at https://www.kcg.com/trading-venues/matchit/downloads/.

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As an initial matter, KCG agrees with the concept of tailoring order handling disclosures by broker-dealers to meet the differing needs of retail and institutional investors. Retail investors should receive reports in a format and containing content that is useful for their purposes. Likewise, institutional investors should have access to information that suits their needs, which would typically contain much more granular information and different data points than that demanded by retail investors. The Proposal's reliance on a $200,000 notional order value, however, as a proxy to delineate between retail and institutional customers is misplaced and problematic. First, $200,000 notional value is a somewhat arbitrary threshold that does not cleanly differentiate between orders sent by retail and institutional investors. Many orders submitted by retail customers are "oversized" and exceed $200,000 and institutions increasingly submit orders for amounts far less than $200,000. Second, relying on notional order value will also skew the order handling report results for investors. Statistics for retail order handling reports will contain smaller order data sent by institutional investors while omitting oversized retail orders; similarly, statistics for institutional order handling reports will include oversized retail orders while omitting smaller orders from institutions.

Rather than relying on notional order value to drive the format and content of order handling reports provided to retail and institutional investors, we believe it would be more appropriate to make this determination based on the manner investors' orders are handled. In other words, the level of order handling disclosure should be determined by whether the broker-dealer has discretion with respect to the handling of a given customer's orders. Specifically, "held" orders - which are typically used by retail customers and for which broker-dealers do not have discretion with respect to order handling - should receive a basic level of order handling disclosure useful for retail customers. "Not-held" orders – which are typically used by institutions and for which broker-dealers maintain discretion - should receive a separate, more complex and granular level of order handling disclosure.

b. Subjective order routing strategies

Under the Proposal, a broker-dealer would be required to assign each order routing strategy it uses for institutional orders into one of three proposed categories (*i.e.*, passive, neutral, or aggressive), include that information in its institutional order handling reports, and document the methodologies relied on in making such assignments. Unfortunately, instead of precisely defining the three proposed order routing strategy categories, the text of the proposed rule merely provides broad descriptions.[6] As the Commission explains in the Proposing Release, it is unable to offer clarity around the proposed order routing strategy categories:

> The Commission is not aware of any generally accepted definitions or metrics to specifically define these order routing strategies, and the proposed rule does not further define these three order routing strategy categories. Rather, by providing a general description, the Commission would offer broker-dealers flexibility to determine how to group their various order routing strategies for institutional orders into three categories for reporting purposes, according to the general description provide in the proposed rule.[7]

The subjectivity involved with broadly designating institutional order routing strategies as passive, neutral, or aggressive is problematic for several reasons. As the Commission notes, each broker-dealer would ultimately have to develop its own internal criteria to determine the strategy category that each algorithm would fall into. We believe this lack of standardization introduces enormous subjectivity into broker-dealers' internal categorization processes. As a result, the methodologies employed would be inconsistent across broker-dealers, which the Commission concedes would "make it difficult for institutional customers to effectively compare institutional order handling reports across their broker-dealers." We concur with the Commission's assessment on this point; it will be extremely difficult for institutional investors to aggregate and interpret such idiosyncratic data across multiple broker-dealers.

In addition, many broker-dealers allow their institutional customers to customize their order routing strategies, which will create further difficulties for broker-dealers in correctly bucketing a given strategy. Again, the subjectivity around the passive, neutral,

[6] Under the proposal, a passive strategy would emphasize the minimization of price impact over the speed of execution of the entire institutional order; a neutral strategy would be relatively neutral between the minimization of price impact and speed of execution of the entire institutional order; and an aggressive strategy would emphasize speed of execution of the entire institutional order over the minimization of price impact. *See* Proposing Release at 49450.

[7] *See* Proposing Release at 49450.

aggressive categorization requirement will skew the output from institutional order handling reports and, therefore, undermine the Proposal's primary goal of enabling institutions to readily compare reports across multiple broker-dealers. Moreover, the usefulness of categorizing order routing strategies as passive, neutral, or aggressive is questionable as there is no indication that institutional investors desire classifications along these lines and several buy-side firms appear to oppose this requirement. Accordingly, we recommend the Commission modify the Proposal to remove this requirement from the final rule.

c. Standardization is essential

In our view, standardization is the key to providing institutional investors with meaningful disclosures regarding the handling and execution of their orders. Put another way, data required to be disclosed by broker-dealers regarding institutional orders needs to be objective and should not be open to subjective interpretation. Also, in attempting to establish universal institutional disclosure regime among broker-dealers, where possible the Commission should leverage existing reliable disclosure infrastructure and avoid imposing a duplicative structure necessitating an inordinately heavy lift for industry participants.

The FIX Trading Community recently addressed an aspect of the issues being considered in the Proposal – specifically, buy-side dissatisfaction with inconsistent execution reporting across the broker-dealer community – when it issued its *Best Practices Around Execution Venue Reporting.*[8] These *Best Practices* define usage expectations around FIX fields regarding execution venue reporting and encourage the sell-side community to implement the outlined practices, which the broker-dealer community has largely adopted. The *Best Practices* encourage sell-side firms to 'tag' trade execution reports with FIX Protocol data that provide the following information in a consistent format to buy-side firms:

[8] The FIX Execution Venue Reporting Best Practice Guidelines can be found at http://www.fixtradingcommunity.org/pg/file/fplpo/read/2836886/fix-execution-venue-reporting-best-practice-guidelines

- Last Capacity (Tag 29): Identifying the capacity of the broker-dealer for an execution (i.e., agent, principal, cross as agent, cross as principal);
- Last Market (Tag 30): Identifying the final destination point of an execution; and
- Last Liquidity Indicator (Tag 851): Identifying the nature of the liquidity, whether the execution was a result of providing or taking liquidity.

The FIX Trading Community's *Best Practices* have been successful in providing the buy-side with objective and consistent information concerning their executions. Today, it is standard practice for buy-side firms to request their broker-dealers to "pass back" relevant FIX Tags, which provides institutional customers with the data necessary to conduct their own order execution analysis. We believe the Commission should consider revising the Proposal to build off the FIX Trading Community's *Best Practices.* We see several benefits to this approach. First, it would lever FIX's existing infrastructure for disclosing data to institutions orders instead of creating an entirely new reporting model. FIX is an industry messaging standard for exchanging trading related information between financial institutions including broker-dealers, institutional investors, and exchanges. It has proven to be reliable, straightforward, and fully standardized. Many institutional investors already have FIX enabled and it is now standard practice for institutions to request their broker-dealers pass back to them FIX Tags on each execution. Second, the goals are closely aligned, as the FIX Trading Community is very focused on ensuring that broker-dealers supply buy-side investors with the data and information they want, which is also one of the primary stated goals of the Proposal.

We recognize that this approach would not address all of the disclosures items considered under the Proposal as the FIX Protocol, at this time, focuses on institutional execution information and not order routing data. However, we understand the FIX Trading Community is considering expanding the FIX Protocol to achieve greater transparency of order routing decisions. In addition, TCA data also captures a great deal of information regarding institutional orders and executions and could serve as an additional resource.

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KCG greatly appreciates the opportunity to comment on the Proposal and would be pleased to discuss these comments in greater detail. If you have any questions, please do not hesitate to contact John A. McCarthy (at [redacted] or [redacted]) or Tom Eidt (at [redacted] or [redacted]).

Sincerely,

John A. McCarthy
General Counsel