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NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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March 31, 2023

Submitted by SEC Webform (<https://www.sec.gov/cgi-bin/ruling-comments>)

Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**RE: File Nos. S7-29-22, Disclosure of Order Execution Information; S7-30-22, Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders; S7-31-22, Order Competition Rule; and S7-32-32, Regulation Best Execution**

Dear Ms. Countryman:

On behalf of the North American Securities Administrators Association (“NASAA”),<sup>1</sup> I am writing in response to the four market structure rule proposals (collectively, the “Proposals”) issued by the U.S. Securities and Exchange Commission (“SEC” or “Commission”) on December 14, 2022: Release No. 34-96493, *Disclosure of Order Execution Information*; Release No. 34-96494, *Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders*; Release No. 34-96495, *Order Competition Rule*; and Release No. 34-96496, *Regulation Best Execution*.<sup>2</sup> NASAA supports the Proposals, with due consideration for the concerns and recommended revisions detailed below.

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<sup>1</sup> Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

<sup>2</sup> The Proposals are available at <https://www.sec.gov/rules/proposed/2022/34-96493.pdf> (*Disclosure of Order Execution Information*); <https://www.sec.gov/rules/proposed/2022/34-96494.pdf> (*Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders*); <https://www.sec.gov/rules/proposed/2022/34-96495.pdf> (*Order Competition Rule*); and <https://www.sec.gov/rules/proposed/2022/34-96496.pdf> (*Regulation Best Execution*). NASAA is consolidating its comments on the Proposals into a single comment letter because of the interconnectedness of the issues raised across the Proposals.

## **I. Introduction**

NASAA supports the Commission's overall goal reflected through the Proposals of strengthening Commission rules related to securities trading and order execution. We are also in support of efforts that facilitate and promote the public capital markets, which we see as an ancillary benefit of the Proposals. We agree that the proposed best execution duties for introducing brokers and executing brokers in *Regulation Best Execution* are appropriate. We agree with the proposed expansions to Regulation NMS Rule 605 disclosures in the *Disclosure of Order Execution Information* proposal. We support the adoption of new Regulation NMS Rule 615 set forth in the *Order Competition Rule* proposal. And we support reducing tick sizes and access fee caps for national market system securities as outlined in the *Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders* proposal. We believe these measures would increase trading efficiencies and improve disclosures for market participants, including retail investors.

NASAA's support for the Proposals, however, is qualified by a few concerns, described more fully below. First, with respect to proposed *Regulation Best Execution*, NASAA encourages the Commission to provide clear guidance in the adopting release on the types of measures that will be required for broker-dealers to demonstrate that they are giving "heightened attention" to conflicted transactions. Second, NASAA recommends the Commission test the proposed summary execution quality reports required by the *Disclosure of Order Execution Information* proposal before implementing that aspect of the proposal to verify that they will be useful for market participants, including individual investors. Third, with respect to the *Order Competition Rule* proposal, we encourage the SEC to assess whether the proposal adequately addresses all potential scenarios for market manipulation and trading volatility to ensure the proposal does not have unintended negative consequences for the marketplace. We believe the Proposals should be adopted once these concerns are addressed.

## **II. Regulation Best Execution**

*Regulation Best Execution* as proposed would, for the first time, institute a best execution duty by operation of SEC regulation. This duty currently exists as an outgrowth of the common law and through the rules of self-regulatory organizations ("SROs").<sup>3</sup> We agree it is appropriate for the Commission to set its own standards for this bedrock duty. *Regulation Best Execution* as proposed would apply to all securities, including securities traded in the national market system ("NMS") and non-NMS securities, as well as novel products such as digital asset securities.<sup>4</sup> Consistent with existing SRO rules, best execution duties would vary slightly depending upon

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<sup>3</sup> Regulation Best Execution Proposal at 11.

<sup>4</sup> *Id.* at 37.

whether a broker-dealer is acting as an “introducing broker” or as an “executing broker,” with introducing brokers subject to more limited duties.<sup>5</sup>

NASAA agrees that all broker-dealers should have the duty to achieve best execution, and that it is appropriate to distinguish the duties owed by introducing brokers from those owed by executing brokers. Given that the proposed definition of introducing broker is narrowly circumscribed to include only brokers that (i) do not carry customer accounts or hold customer funds or securities, (ii) execute all transactions through other unaffiliated broker-dealers, and (iii) do not accept remuneration or other consideration for routing order flow for execution, it is appropriate to subject these brokers to reduced best execution duties, as outlined in the proposal; namely, to periodically review their order executions, compare their order execution quality against other potential executions that might have been obtained through other executing brokers, and to revise their order handling procedures accordingly.<sup>6</sup>

Broker-dealers who actually execute trades, be it on an exchange, over the counter (“OTC”) or through internalization, should be subject to the duty of best execution set forth in the proposal.<sup>7</sup> These executing brokers would be required, in any transaction with or for a customer and whether acting as an agent or on a principal basis, to “use reasonable diligence to ascertain the best market for [the] security, and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.”<sup>8</sup> Executing brokers further would have to establish and enforce internal policies and procedures reasonably designed to fulfil this obligation (including as to the best displayed prices, opportunities for price improvement including midpoint executions, attributes of particular customer orders, and the trading characteristics of the security at issue).<sup>9</sup> This duty would be similar to, but not coextensive with, the existing duties imposed by SRO rules.<sup>10</sup> Furthermore, executing brokers would have to give “heightened attention” in their policies and procedures to how they will achieve best execution for conflicted transactions, defined in the proposal as any transaction for or with a retail customer in which the broker-dealer stands as principal, routes the order to an affiliate for execution, or receives or provides payment for order flow (“PFOF”).<sup>11</sup>

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<sup>5</sup> *Id.* at 145-55.

<sup>6</sup> *Id.* at 145, 151.

<sup>7</sup> *Id.* at 50-51.

<sup>8</sup> *Id.* at 41.

<sup>9</sup> *Id.* at 42.

<sup>10</sup> *Id.* at 48.

<sup>11</sup> *Id.* at 28, 100-01.

NASAA broadly agrees with these standards. Requiring introducing brokers to (i) monitor their order executions, (ii) periodically assess whether they could be achieving better execution through other executing brokers, and (iii) document such assessments and conclusions would all be new duties for these firms that are not currently required to do by SRO rules.<sup>12</sup> However, requiring such diligence is reasonable given the centrality of best execution to the role and responsibilities of a broker. These standards should have the effect of improving introducing brokers' order execution quality and resulting prices for investors. Further, we believe compliance with these duties would not prove unduly burdensome.

In addition, we agree that a requirement for robust best execution compliance policies and procedures, particularly with respect to conflicted transactions, is appropriate for executing brokers. Together, these requirements should incentivize executing brokers to compete for orders, which would at least sustain and perhaps could increase efficiencies in the marketplace. NASAA has previously expressed its concerns over the extent to which broker-dealers profit from PFOF at the expense of retail investors, as well as the extent to which PFOF arrangements can cause broker-dealers to urge investors to trade unnecessarily.<sup>13</sup> Requiring "heightened attention" to this issue should help broker-dealer firms – and federal and state securities regulators conducting examinations – identify, prevent and remediate potential misuses of PFOF.

If the Commission moves to adopt the proposal, it should provide clear guidance in the adopting release on the types of measures that are required for broker-dealers to demonstrate "heightened attention" to conflicted transactions. Doing so at this point would facilitate effective implementation of this proposal. As the Commission knows from its experience with Regulation Best Interest, uncertainties regarding new regulatory requirements can sometimes require staff guidance and examination risk alerts – with ensuing months or years of delay – before industry fully understands and acknowledges what is expected of them.

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<sup>12</sup> *Id.* at 152.

<sup>13</sup> See Letter from Melanie Senter Lubin, NASAA President, to Vanessa A. Countryman, SEC Secretary, Re: *Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice* at 4 n.11 (Oct. 1, 2021), available at <https://www.nasaa.org/wp-content/uploads/2021/10/NASAA-Comment-Letter-for-File-No-S7-10-21-Digital-Engagement-Practices-and-Investment-Adviser-Technologies.pdf>.

### III. Disclosure of Order Execution Information

The *Disclosure of Order Execution Information* proposal would amend existing order disclosure rules under Regulation NMS Rule 605<sup>14</sup> to broaden the scope of reporting entities subject to this rule, change how orders are categorized for purposes of the rule, and modify the scope of information that must be reported.<sup>15</sup> These proposed changes are intended to enable market participants to better assess execution quality across trading venues.<sup>16</sup>

Currently, Rule 605 requires “market centers,” defined as any exchange market maker, OTC market maker, alternative trading system, national securities exchange, or national securities association, to publish monthly order execution information.<sup>17</sup> Many large broker-dealers that are responsible for significant order traffic can avoid Rule 605 requirements currently because they do not fall within the definition of a market center. The proposal would expand the scope of Rule 605 reporting entities by adding (i) broker-dealers that introduce or carry 100,000 or more customer accounts, (ii) single-dealer platforms, and (iii) broker-dealers that operate qualified auctions under the proposed order competition rule (discussed below).<sup>18</sup> The proposal would also adjust the type of information to be disclosed under Rule 605 and how that information is organized, as well as require that Rule 605 data be made available in summary formats that are more digestible for market participants, including individual investors.<sup>19</sup>

NASAA has consistently supported market efficiency, fair competition, and transparency, which all align with the national market system objectives of Section 11A of Securities Exchange Act of 1934.<sup>20</sup> We agree that expanding Rule 605 disclosures, both as to the number of entities that must make the required disclosures and the scope of information contained in these reports, would foster fair competition and price transparency. Expanding the scope of entities that must make Rule 605 disclosures is appropriate because it would provide the public with a more

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<sup>14</sup> 17 C.F.R. § 242.605.

<sup>15</sup> Disclosure of Order Execution Information Proposal at 1.

<sup>16</sup> *Id.* at 5.

<sup>17</sup> See 17 C.F.R. § 242.600(b)(46) (definition of “market center”).

<sup>18</sup> Disclosure of Order Execution Information Proposal at 39, 65, 71.

<sup>19</sup> *Id.* at 74, 147-58.

<sup>20</sup> See Letter to President Biden Regarding Securities Laws and Economic Stimulus Legislation (Jan. 21, 2021), available at <https://www.nasaa.org/wp-content/uploads/2021/01/Letter-to-President-Biden-on-Securities-Laws-and-Stimulus-012121.pdf>; see also *NASAA Federal Policy Agenda for the 118th Congress* at 4-6 (Jan. 5, 2023), available at <https://www.nasaa.org/wp-content/uploads/2023/01/NASAA-Federal-Policy-Agenda-Last-Updated-January-5-2023.pdf>; see generally Written Testimony of Joseph P. Borg, NASAA President, before the U.S. House Committee on Financial Services Subcommittee on Capital Markets, Securities, and Investment, *Ensuring Effectiveness, Fairness, and Transparency in Securities Law Enforcement* (June 13, 2018), available at <https://www.nasaa.org/wp-content/uploads/2018/06/Written-Testimony-of-NASAA-President-Joseph-Borg-HFSC-CM-Hearing-June-13-2018.pdf>.

comprehensive view of order execution quality across the national market system. This sort of ‘comparison shopping’ information would allow brokerage customers to compare execution quality among different broker-dealers, particularly given the requirement in the proposal that Rule 605 disclosures would include summary statistics more accessible to laypeople, rather than the large data files through which Rule 605 disclosures are currently made.<sup>21</sup> The knowledge that this information would be public should also provide an additional incentive to broker-dealers to better compete for execution quality or find ways to make the overall cost of trading more attractive to their customers. It is reasonable to conclude, as the Commission does, that this competition should lead to “faster executions, better price improvement, and a shift in order flow to those broker-dealers offering the best execution quality for their customers.”<sup>22</sup>

However, NASAA strongly encourages the Commission to test the proposed summary execution quality reports prior to implementing them. We agree that raw Rule 605 data is unlikely to be useful for most individual investors; the additional obligation to provide summary statistics in an accessible format is essential to make the Rule 605 data useful for a wider swath of market participants. The proposal would mandate seven components to these statistics: (i) average order size; (ii) percentage of shares executed at the quote or better; (iii) percentage of shares that received price improvement; (iv) average percentage price improvement per order; (v) average percentage effective spread; (vi) average effective over quoted spread, expressed as a percentage; and (vii) average execution speed, in milliseconds.<sup>23</sup> If one of the anticipated benefits of the proposal is to empower individual investors through better information, then the Commission should expend the effort necessary to be confident that the information presented is truly useful to them. We thus encourage the Commission to test these components with investors, particularly retail investors, prior to implementing them (such as through focus groups) to confirm they provide information that retail investors would find useful.<sup>24</sup> Provided they do, the Commission could then institute these new standards either by setting an implementation date that gives the Commission sufficient time to test the reports, or through a subsequent Commission order following adoption of the proposal.

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<sup>21</sup> See Disclosure of Order Execution Information Proposal at 150-52.

<sup>22</sup> *Id.* at 43.

<sup>23</sup> *Id.* at 432-33 (proposed Rule 605(a)(2)).

<sup>24</sup> Similar to NASAA’s recommendation regarding Form CRS, comprehensive testing of summary statistics reports would yield assessments as to the report’s format, content, and utility to ensure the scope of the data is appropriate for a retail investor’s analysis. See Letter from Joseph Borg, NASAA President, to Brent Fields, SEC Secretary, Re: *Consolidated Comments in Response to SEC Proposed Rulemakings: Regulation Best Interest, Form CRS Relationship Summary, Amendments to Form ADV, Required Disclosures, and Restrictions on the Use of Certain Names for Titles, and Standards of Conduct for Investment Advisers* at 3, 15 (Aug. 23, 2018), available at <https://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Reg-BI-Comment-Letter-8-23-2018.pdf>.

#### IV. Order Competition Rule

The *Order Competition Rule* proposal puts forward a new proposed Rule 615 under Regulation NMS. Rule 615 would regulate the execution of “segmented orders” submitted by “individual investors,” defined in the proposal as natural persons who trade infrequently for their own or a closely related account.<sup>25</sup> Rule 615 would require broker-dealers to expose such orders to competition in fair and open market auctions before they could be executed internally.<sup>26</sup> The Commission’s analysis of market trading data indicates that a “competitive shortfall” exists between the prices individual investors would enjoy if their orders were exposed to fair and open competition and the actual prices at which their trades are currently executed.<sup>27</sup> The proposal seeks to close this gap and ensure retail investors receive the best prices available in the marketplace. The SEC anticipates the proposal will lead to a reduction in the use of PFOF in equity markets, which “may weaken the competitive position of retail brokers that are dependent on PFOF revenue but strengthen the competitive position of retail brokers that are not” dependent upon it.<sup>28</sup> While NASAA notes the Commission’s analysis and conclusion that the proposal would be unlikely to cause broker-dealers to resume charging commissions to retail investors for their own online securities orders,<sup>29</sup> NASAA asks the Commission to pay close attention to comments on the anticipated effects of the proposal on commission-free trading.

NASAA supports exposing individual investor orders to competition because the efficiency of the public trading markets, coupled with the combined trading interests of the widest available swath of potential counter parties, should provide better opportunities for such orders to trade at the best market prices available. We also believe the proposal is appropriately calibrated to protect retail investors. Exceptions to the requirements of Rule 615 would include individuals who trade many times per day (such as day traders)<sup>30</sup> and orders valued at \$200,000 or more (which are more indicative of institutional investors or high net worth individuals).<sup>31</sup> We also note with approval features of the proposal to ensure that traders with the fastest systems are unable to gain advantages by monitoring and reacting to auction responses.<sup>32</sup>

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<sup>25</sup> Order Competition Rule Proposal at 14.

<sup>26</sup> *Id.* at 5-6.

<sup>27</sup> *Id.* at 9-11.

<sup>28</sup> *Id.* at 185.

<sup>29</sup> *Id.* at 293-95.

<sup>30</sup> *See id.* at 80-81.

<sup>31</sup> *See id.* at 102.

<sup>32</sup> *See id.* at 112.

However, we encourage the SEC to consider whether all potential trading ahead or market manipulation possibilities have been accounted for in the proposed rule,<sup>33</sup> as well as how periods of market stress arising out of mass individual investor trading in a particular security (such as meme stock trading) could impact the auction requirements. The Commission acknowledges that it is “uncertain how liquidity would be impacted by increased volatility within the context of qualified auctions.”<sup>34</sup> That is concerning. As the Commission knows, liquidity can vanish unexpectedly in times of extraordinary market stress and market participants can withdraw from the market in the face of uncertain trading conditions.<sup>35</sup> Recent phenomena, including the January 2021 meme stock disruptions<sup>36</sup> and the run on Silicon Valley Bank,<sup>37</sup> show that volatility and ensuing market disruptions can happen in ways that could make it difficult for public auctions to function. The Commission should carefully consider whether and how requiring segmented orders to be exposed to open auctions could either (i) create slippage which harms the prices available to individual investors or (ii) become a source of market volatility itself.

#### V. Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders

The *Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders* proposal would amend Regulation NMS rules to adjust the minimum pricing increments (also known as “ticks”) for stock quotes. The purpose would be to increase liquidity in NMS stocks that are “tick constrained” – *i.e.*, stocks that could trade on a narrower spread than is currently permitted by SEC pricing rules.<sup>38</sup> The proposal would set new minimum quarterly tick sizes for every stock priced at \$1.00 or greater to be calculated as the time weighted average quoted spread for the stock

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<sup>33</sup> For instance, while high frequency traders would not be able to see bid and offer activity on an order during an auction, they would be able to see incoming auction announcements, as well as the orders themselves, which in turn could create opportunities to trade against anticipated incoming order activity. Such opportunities would be most rich when multitudes of individual investors are reacting to news reports or social media prompting, which in turn could lead to the markets moving against individual investors more quickly.

<sup>34</sup> *See id.* at 288 n.570.

<sup>35</sup> *See* SEC, *Findings Regarding the Market Events of May 6, 2010* at 6 and 32-37 (Sept. 30, 2010), available at <https://www.sec.gov/files/marketevents-report.pdf> (describing the breakdown in the price discovery process created by the withdrawal of multiple market participants); *see also* SEC, *Concept Release on Equity Market Structure*, SEC Rel. No. 34-61358 at 50 (Jan. 14, 2010), available at <https://www.sec.gov/rules/concept/2010/34-61358.pdf> (asking whether the orders of proprietary trading firms should be “characterized as phantom liquidity that disappears when most needed by long-term investors and other market participants”).

<sup>36</sup> *See* SEC, *Staff Report on Equity and Options Market Structure Conditions in Early 2021* at 37-39 (Oct. 14, 2021), available at <https://www.sec.gov/files/staff-report-equity-options-market-structure-conditions-early-2021.pdf> (describing the relationship between market volatility and liquidity crunches for GameStop stock in January 2021).

<sup>37</sup> *See* Jonathan Yerushalmy, ‘The first Twitter-fuelled bank run’: how social media compounded SVB’s Collapse, *The Guardian* (Mar. 16, 2023), available at <https://www.theguardian.com/business/2023/mar/16/the-first-twitter-fuelled-bank-run-how-social-media-compounded-svbs-collapse>.

<sup>38</sup> Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Price Orders Proposal at 11.



during the last month of the preceding quarter (with responsibility for determining these tick sizes to fall upon the stock's primary listing exchange).<sup>39</sup> The proposal would also reduce the maximum access fees that trading centers can charge under Regulation NMS Rule 610(c) and prohibit trading centers from charging fees that are not determinable at the time of order execution.<sup>40</sup>

NASAA supports reducing tick sizes for NMS stocks. Reducing tick sizes should result in increased liquidity and more efficient pricing in the public markets. Permitting registered exchanges and alternative trading systems to accept quotes in smaller increments should further help those venues to compete with OTC market participants who are able to trade more freely in sub-penny increments, which should increase the volume of trades executed in regulated venues.<sup>41</sup> To the extent that reducing tick sizes increases the volume of trades executed on securities exchanges and other public trading venues, NASAA believes the proposal is in the public interest. Trading in dark pools and other nonpublic venues is subject to conflicts of interest that do not exist, or at least are mitigated, in the public markets.

Reducing access fee caps alongside the reduction in tick sizes is also sensible so as to ensure that access fees do not become an outsized portion of displayed price quotes.<sup>42</sup> Furthermore, reducing access fee caps could help reduce incentives for broker-dealers to route orders to trading venues that benefit those broker-dealers (such as venues in which a broker-dealer is rebated), but may provide suboptimal execution to the detriment of the broker-dealer's customers. Reducing access fee caps should in turn apply downward pressure on rebates, thereby reducing the financial incentive to route orders to particular venues for execution. Finally, requiring that fees be determinable at the time of order execution should make transaction costs more transparent, empowering brokerage customers with a greater ability to assess the reasonableness of fees and the potential to obtain reduced fees at other venues, as well as to further mitigate the effect of rebates by incentivizing firms to share those benefits with their customers. However, we would encourage the Commission to include a mechanism in the rule to periodically re-evaluate the access fee caps set in the proposal to ensure that access fee levels continue to have the anticipated benefits.

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<sup>39</sup> *Id.* at 58.

<sup>40</sup> *Id.* at 94, 107.

<sup>41</sup> *See id.* at 12-13.

<sup>42</sup> *See id.* at 97.

Vanessa A. Countryman

March 31, 2023

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**VI. Conclusion**

For the reasons described above, NASAA supports the Proposals and encourages their adoption with the caveats and recommendations described above. We believe all four Proposals stand to benefit retail investors and the securities marketplace more generally. Should you have any questions about this letter, please contact either the undersigned or NASAA's General Counsel, Vince Martinez, at (202) 737-0900.

Sincerely,



Andrew Hartnett  
NASAA President and  
Deputy Commissioner,  
Iowa Insurance Division