

January 30, 2024

Ms. Vanessa Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-32-22; Release No. 34-96496; Regulation Best Execution

Dear Ms. Countryman:

Goldman Sachs & Co. LLC (“Goldman”) appreciates the opportunity to provide the Securities and Exchange Commission (“SEC” or the “Commission”) with additional comments on proposed Regulation Best Execution (the “Best Execution Proposal”).¹ These comments supplement those Goldman provided in its March 31, 2023 letter.²

We support capital markets regulations that advance resiliency, efficiency, and fairness, and share the SEC’s belief that a broker dealer’s duty of best execution is foundational to public confidence in our markets. However, we believe that the Best Execution Proposal diverges from the well-functioning existing best execution framework (hereinafter, the “FINRA/MSRB framework” or “current framework”) in material ways that will harm customer order execution quality. Therefore, we are supplementing our original comments on the Best Execution Proposal to illustrate and underscore the consequence of these differences: the curtailment of a broker-dealer’s ability to exercise its judgment and expertise, and the resulting negative impact on execution quality for institutional client orders and other large orders.

The Best Execution Proposal and the FINRA/MSRB framework differ in two important respects in that the Proposal: (1) shifts how best execution is evaluated from a dynamic process, anchored by regular and rigorous review, to inflexible preset procedures for order routing decisions; and (2) over-emphasizes “best price” while de-emphasizing other important execution quality factors. We submit this supplemental comment letter to provide the Commission with two streamlined examples that illustrate the differences between the current and proposed best execution frameworks.³

¹ Exchange Act Release No. 96496 (Dec. 14, 2022), 88 FR 5440 (Jan. 27, 2023).

² See Letter from J. Schriber to V. Countryman (Mar. 31, 2023).

³ For ease of understanding, the order handling and routing examples we provide are simplified. They are for illustrative purposes only. Among other things, the examples do not include details regarding the varied and numerous

I. Order Handling and Routing Decisions are Required to be Preset, Limiting Flexibility

Proposed Rule 1101(a)(2) of the Best Execution Proposal requires broker-dealers to set forth in detailed procedures “how [they] will determine the best market and make routing and execution decisions for the customer orders that [they] receive[.]” including, among other things, “the number and sequencing of markets to be assessed.” Accordingly, although market events and conditions cannot be predicted, the proposed rule requires broker-dealers to draft a pre-set game plan, codified in their policies and procedures, detailing every potential permutation of, and predicted market outcome for, its order handling and routing decisions for customer orders. Adherence to this pre-set game plan, regardless of changed or unanticipated market conditions, is the litmus test by which a broker-dealer will be deemed to have satisfied its duty of best execution.

Such requirement is very different from the current best execution framework, which is founded upon the “regular and rigorous review” testing standard that enables firms to look back at the results of their decisions within the context of the entire market, examine them, and make forward-looking adjustments. By mandating that broker-dealers determine and “lock in” their decision-making in advance, the proposed rule effectively eliminates an essential element of best execution: the ability of broker-dealers to exercise their judgment and expertise. This element is especially critical for institutional and other large orders. For example, when handling large institutional orders, a broker-dealer might customarily split the large order (parent order) into smaller sub-orders (child orders) for routing and execution. Under these circumstances, a broker-dealer must continuously assess how routing decisions and execution of the child orders in a dynamic market are impacting the average price and execution quality for the yet unexecuted portion of the parent order.

The following example is an illustration:

A broker-dealer receives a not held order for 500,000 shares in an exchange-listed stock. It parses the parent order into smaller child orders and begins routing them to the designated execution venues in the sequence set forth in its policies and procedures. As required by the Best Execution Proposal, the broker-dealer’s policies and procedures state that orders of such size must be routed to the following execution venues, in sequence informed by historical execution quality metrics:

Exchanges:

1. Exchange A
2. Exchange B
3. Exchange C

market data points that inform order routing decisions, nor venue-specific metrics and information. For equities (although the Best Execution Proposal is applicable to all U.S. securities), the complexity of the marketplace is a function of, among other things, the number and diversity of execution venues, which include 16 exchanges, more than 30 registered alternative trading systems, and several single dealer platforms.

Alternative Trading Systems (“ATsS”):

4. ATS D
5. ATS E
6. ATS F

Midway through the order, the broker-dealer notices a pattern of larger and more immediate fills on Exchange B, suggesting a better performance opportunity for the parent order. Although there is no change in the prevailing price on the other venues, the broker-dealer expects that the fill rate and performance on Exchange B will continue to positively deviate from historical patterns and lead to better performance.

Under the current best execution framework, the broker-dealer would be able to exercise discretion and make dynamic changes to its routing to increase the percentage of shares routed to Exchange B compared to the other venues. The broker-dealer would subsequently assess the reasonableness of its decision in view of the whole market during its post-execution “regular and rigorous review” process, which includes an analysis of venue performance and impact on parent order level execution quality.

Under the Best Execution Proposal, however, the broker-dealer is unable to deliver this benefit to their client and must continue to route in line with the pre-set decisions memorialized in its policies and procedures, including those regarding the number and sequencing of markets for routing or risk violating the rule.⁴ As a result, the client loses the benefit of the broker-dealer’s judgment and expertise, likely resulting in its receipt of a lower fill rate and potentially worse overall execution quality.

This example makes clear that the Best Execution Proposal’s re-orientation of the standard for evaluating best execution from one of reasonable diligence coupled with regular and rigorous review of the results to one of adherence to a set of pre-established decisions captured in a set of procedures, significantly restricts the flexibility needed to achieve best execution. Although we appreciate the value of requiring broker-dealers to consider a range of factors with respect to their customer order handling, we believe that best execution practices would be better served if such considerations were part of broker-dealers’ review of execution quality.⁵

⁴ See, e.g., 88 FR at 5442 (providing that a “broker-dealer’s failure to achieve the most favorable price for customer orders would not necessarily be a violation of the proposed best execution standard . . . [h]owever, a failure to establish and maintain reasonably designed policies and procedures applicable to all customer orders, or a failure to enforce those policies and procedures, would be a violation of the policies and procedures requirement under proposed Regulation Best Execution”).

⁵ In so doing, the Best Execution Proposal would be structured similarly to the current framework, which centers upon a broker-dealer’s satisfaction of the regular and rigorous review requirement of FINRA Rule 5310.09 in accordance with FINRA’s detailed guidance. See, e.g., FINRA Reg. Notice 15-46 (Nov. 20, 2015) (providing guidance and specific details regarding the requirements of FINRA Rule 5310.09 and how broker-dealers should conduct regular and rigorous reviews); FINRA Reg. Notice 21-23 (Jun. 23, 2021) (explaining how broker-dealers receiving or providing payment for order flow should conduct a regular and rigorous review of execution quality).

II. Other Factors Diluted by Overemphasis on Price

While price is often an important factor in evaluating whether a broker-dealer provided its customer with best execution, it is not always the paramount factor. For customers who trade large-sized orders, factors such as certainty and speed of execution may be of greatest importance for best execution at the parent order level. When prioritizing such factors, best price will not always dominate child order routing decisions in the same way it might for a standalone retail order. However, because the Best Execution Proposal prioritizes the “most favorable price”⁶ over other important execution-related considerations, institutional orders risk receiving an inferior overall execution.

The following example is an illustration:

Assume a broker-dealer receives a large not held buy order for one million shares in an exchange-listed stock. Due to its size, the order will take longer to execute and, thus, will be susceptible to market impact and information leakage. In accordance with the Best Execution Proposal, the broker must seek to obtain the “most favorable price” for the order and, accordingly, begins to employ a pre-set order routing methodology designed to (1) capture some liquidity at the National Best Offer on public exchanges, and (2) search for potentially better priced shares by sending a series of child orders to non-displayed venues (e.g., ATSS). Under the current best execution framework, and in accordance with its judgment and market expertise, the broker-dealer can pivot its approach during the life of the order and choose to execute additional volume at slightly inferior prices to capture then-available liquidity. However, under the Best Execution Proposal, the broker-dealer must continue to preference venues with any liquidity at the best price, despite the potential for an inferior overall execution of the parent order.

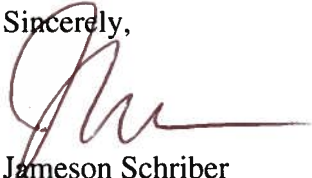
III. Conclusion

Goldman Sachs appreciates the opportunity to provide these additional comments on the Best Execution Proposal. We hope the Commission finds them helpful and considers them carefully. As demonstrated above, the Best Execution Proposal will alter the current best execution framework in ways that will have the unintended result of inferior execution quality being provided to many customers on their orders due to the curtailment of broker-dealer judgment and expertise. In addition, we are also concerned that the negative impact on execution quality may be most pronounced during periods of market stress when a broker-dealer’s judgment and expertise is most critical.

⁶ See 88 FR at 5442 (noting that a “broker-dealer’s failure to achieve the most favorable price possible under prevailing market conditions . . . would be part of the consideration of whether the broker-dealer’s policies and procedures are reasonably designed and whether the broker-dealer is enforcing its policies and procedures”); *see also id.* at 5459-63.

We would be pleased to discuss any of the comments or suggestions in this letter with the Commission or the Staff in more detail. Please feel free to contact the undersigned with any questions.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Jameson Schriber', with a long horizontal flourish extending to the right.

Jameson Schriber
Managing Director
Goldman Sachs & Co. LLC

cc: Gary Gensler, Chairman
Hester M. Peirce, Commissioner
Caroline A. Crenshaw, Commissioner
Mark T. Uyeda, Commissioner
Jaime Lizarraga, Commissioner

Haoxiang Zhu, Director, Division of Trading and Markets