

FINANCIAL INFORMATION FORUM

April 13, 2023

By electronic mail to rule-comments@sec.gov

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attn: Secretary

Re: File Number SR-FINRA-2022-031: Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Change to Adopt FINRA Rules 6151 (Disclosure of Order Routing Information for NMS Securities) and 6470 (Disclosure of Order Routing Information for OTC Equity Securities)

Dear Secretary,

The Financial Information Forum (“FIF”)¹ submits this letter in connection with the issuance by the Securities and Exchange Commission (the “Commission”) on March 3, 2023 of an “Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Change to Adopt FINRA Rules 6151 (Disclosure of Order Routing Information for NMS Securities) and 6470 (Disclosure of Order Routing Information for OTC Equity Securities)” (the “Order”).² The Order relates to a proposed rule change (SR-FINRA-2022-031) filed by the Financial Industry Regulatory Authority (“FINRA”) with the Commission on November 16, 2022 (the “proposed rule change”)³ and the Commission’s associated

¹ FIF (www.fif.com) was formed in 1996 to provide a centralized source of information on the implementation issues that impact the securities industry across the order lifecycle. Our participants include broker-dealers, exchanges, back office service bureaus, and market data, regulatory reporting and other technology vendors in the securities industry. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

² Securities Exchange Act Release No. 97039 (Mar. 3, 2023), 88 FR 14653 (“Order”).

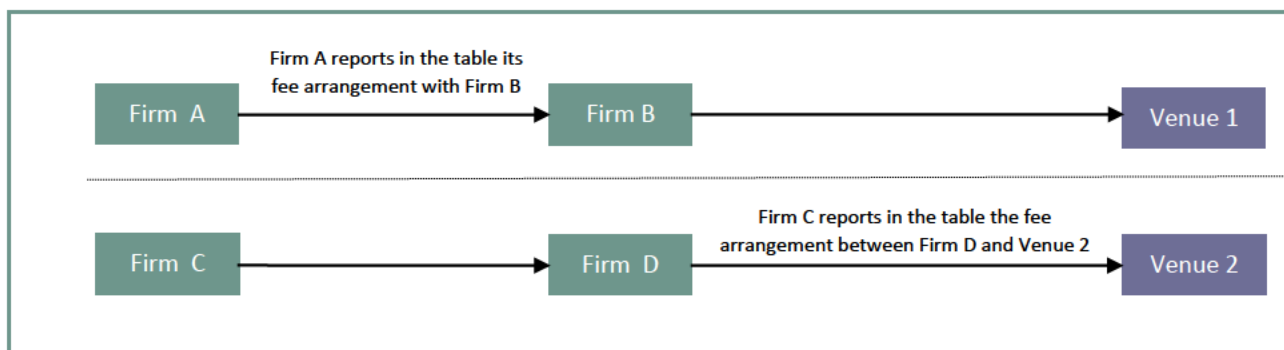
³ Financial Industry Regulatory Authority, “Proposed Rule Change to Adopt FINRA Rules 6151 (Disclosure of Order Routing Information for NMS Securities) and 6470 (Disclosure of Order Routing Information for OTC Equity Securities),” SR-FINRA-2022-031 (Nov. 16, 2022), available at <https://www.finra.org/sites/default/files/2022-05/SR-FINRA-2022-013.pdf> (“FINRA Rule Proposal”).

Notice of Filing published on November 30, 2022 (the “Notice of Filing”).⁴ This letter is submitted in response to a letter submitted by FINRA on March 29, 2023 (the “FINRA response letter”).⁵

In response to the Notice of Filing, FIF submitted comment letters on December 20, 2022⁶ and February 3, 2023.⁷ As indicated in a letter submitted by FIF on March 30, 2023 in response to the Order, FIF members continue to have the same concerns relating to the proposed rule change as discussed in our prior comment letters.⁸ Our concerns are specific to the look-through requirement of the proposed rule change; we have discussed these concerns in detail in our December comment letter, including the fact that the look-through requirement requires the disclosure of confusing and misleading information to investors and the public. In our December comment letter, FIF members propose an alternative to the look-through requirement whereby a reporting firm would report in the FINRA venues table the firm to which the reporting firm directly routes a customer order; this alternative would provide clear and accurate disclosure to investors and the public.

A. Look-through provides confusing and misleading information to investors and the public and data that is not comparable across reporting firms

The FINRA response letter does not adequately address the primary concern that FIF members have identified about the proposed rule change, which is that the proposed rule change would require industry members to disclose confusing and misleading information to investors and the public. In our December 20, 2022 letter, FIF discusses and illustrates the following scenario to demonstrate this point.



Scenario:

- Reporting Firm A routes directly to Firm B

⁴ Securities Exchange Act Release No. 96415 (Nov. 30, 2022), 87 FR 74762 (Dec. 6, 2022).

⁵ Letter dated March 29, 2023 from Robert McNamee, Associated General Counsel, FINRA, available at <https://www.finra.org/sites/default/files/2023-03/FINRA-2022-031-Response-to-Comments-3-29-2023.pdf> (“FINRA Response Letter”).

⁶ Available at <https://www.sec.gov/comments/sr-finra-2022-031/srfinra2022031-20153223-320697.pdf>.

⁷ Available at <https://www.sec.gov/comments/sr-finra-2022-031/srfinra2022031-20156482-324634.pdf>. We do not discuss in this letter reporting for routes through OTC Link, which was the focus of the comment letter we submitted on February 3. Reporting for routes through OTC Link is a distinct issue and not addressed in this letter.

⁸ Available at <https://fif.com/index.php/working-groups>. Our December, February and March comment and response letters are hereby incorporated into this response letter.

- Firm B routes orders; Firm B also trades as principal and crosses orders; the Commission considers Firm B to be a venue for Rule 606(a) reporting purposes
- Reporting Firm C routes directly to Firm D
- Firm D routes orders; Firm D does not trade as principal or cross orders; the Commission does not consider Firm D to be a venue for Rule 606(a) reporting purposes.

As discussed in our December comment letter, look-through means that Firm C, instead of reporting in the FINRA venues table the financial arrangements between Firm C and Firm D, reports the financial arrangements between Firm D and Venue 2. With look-through, Firm A would be reporting in the FINRA venues table the financial arrangements between Firms A and B, while Firm C would be reporting in the FINRA venues table the financial arrangements between Firm D and each execution venue to which Firm D routes orders. This means that the data reported by Reporting Firms A and C is not comparable. This lack of comparability is detrimental to retail investors and inconsistent with one of FINRA's important stated objectives for the rule proposal: comparability of reports.⁹

The lack of comparability is confusing for investors and the public because a row in a table reported by one reporting firm is reporting on the fee arrangement between the reporting firm and the routing firm, while a row in a table reported by another reporting firm is reporting on the fee arrangement between the routing firm and the execution venue, and this distinction is not apparent to someone viewing the reports. This same lack of comparability can occur within different rows reported by a single reporting firm, and a single row of a report can include both direct and indirect fee information. This lack of comparability across rows reported by different reporting firms (and also by the same reporting firm) results in misleading information being disclosed to investors and the public because investors and the public would reasonably (but wrongfully) assume that rows within and between reports (where the rows have the same column headings) would be reporting equivalent data.

B. Misleading disclosure is worse than no disclosure

In our December comment letter, FIF members propose an alternative to look-through; this alternative would provide clear and accurate disclosure to investors and the public and ensure that the data reported by different reporting firms is comparable. Under this alternative, a reporting firm would report in the FINRA venues table the firm to which the reporting firm directly routes a customer order. If the Commission does not agree with this alternative approach proposed by FIF members, FIF members recommend that the Commission reject the proposed rule change because misleading disclosure is worse than no disclosure.

C. Reporting of look-through arrangements is not relevant for investors and results in relevant information being excluded from the reporting tables

Apart from the fact that reporting of look-through is confusing and misleading for investors (as discussed above) and results in the reporting of data that is not comparable across reporting firms, look-through information is not relevant for investors. FINRA writes as follows in the FINRA rule filing:

⁹ FINRA Rule Proposal, at 22.

Customers would be able to better compare indirect trading costs and whether payment for order flow received and net transaction fees paid, considering rebates, may be affecting the routing decisions of some firms more than others or causing changes in routing behavior over time. The information in these reports would permit customers to evaluate firms' routing decisions more effectively and be better informed in making choices among firms.¹⁰

The financial arrangements between an intermediary routing firm and an execution venue have no effect on the routing decisions of a reporting firm. What impacts the routing decisions of a reporting firm are the financial arrangements between the reporting firm and the intermediary routing firm. Accordingly, look-through removes from the table information that is relevant to the purpose of the rule, as expressly stated by FINRA, and inserts in its place information that is not relevant to the purpose of the rule.

D. In certain scenarios, look-through results in important information being excluded from the report

In certain scenarios, look-through results in important information being excluded from the report. The following scenario is based on an actual Rule 606(a) scenario presented by an FIF member. We have greatly simplified the facts (including the quantities) to maintain the anonymity of the reporting firm and to illustrate the problem more clearly.

Scenario:

- During a reporting period, a reporting firm routes the following number of orders to the following firms:
 - Market maker 1 (MM1): 1,000 orders
 - Market maker 2 (MM2): 1,000 orders
 - Routing firm 1 (RF1): 1,000 orders
- For purposes of Rule 606(a) reporting, RF1 is not an “execution venue” as defined by the Commission
- RF1 routes the following child routes in relation to the 1,000 orders routed by the reporting firm to RF1:
 - ATS 1: 2,000 orders
 - ATS 2: 2,000 orders
 - ATS 3: 2,000 orders
 - ATS 4: 2,000 orders
 - ATS 5: 2,000 orders
 - Exchange 1: 2,000 orders
 - Exchange 2: 2,000 orders
 - Exchange 3: 2,000 orders

¹⁰ Ibid.

- Exchange 4: 2,000 orders
- Exchange 5: 2,000 orders

Because of the routing strategies employed by routing firms, including the use of child orders and route modifications (for example, to change the routed price as market conditions change), the number of orders that a routing firm routes often exceeds the number of orders that the routing firm receives. This common occurrence is illustrated in the scenario above where RF1 receives 1,000 orders and routes 20,000 orders.

Under Rule 606(a), a firm is only required to report on “... the ten venues to which the largest number of total non-directed orders for the section were routed for execution and of any venue to which five percent or more of non-directed orders were routed for execution.”¹¹ Based on this standard and the application of look-through, the reporting firm would exclude MM1 and MM2 from its Rule 606(a) report even though the reporting firm’s routes to MM1 and MM2 represent 66.7% of the reporting firm’s routing activity.

With the alternative to look-through proposed by FIF members, 100% of the reporting firm’s direct routing activity would be reported in the Rule 606(a) tables.

E. Two confusing and misleading reports don’t make a clear and accurate report

“Two wrong don’t make a right” is a well-known proverb. A corollary to this proverb is that “two confusing and misleading reports don’t make a clear and accurate report”. FINRA writes as follows in the FINRA response letter: “Aligning the scope of the Rule 606(a) and OTC Equity Security reports would also reduce potential investor confusion that could arise with parallel reports that do not provide information about the same types of venues.”¹² FIF members disagree with this assertion.

As discussed above, the report that FINRA is proposing would provide confusing and misleading information to investors and the public. This report copies the look-through approach that the Commission mandated subsequent to the adoption of the 2018 amendments to Rule 606(a).¹³ Because of look-through, the Rule 606(a) reports provide confusing and misleading information to investors and the public. Mandating a second report that provides the same confusing and misleading information as provided in the Rule 606(a) report does not make either report (the Rule 606(a) report or the FINRA report) any less confusing or misleading. It only means that now there are two confusing and misleading reports instead of one.

¹¹ 17 CFR §242.606(a).

¹² FINRA Response Letter, at 4.

¹³ Securities Exchange Act Release No. 84528 (Nov. 2, 2018), 83 FR 58338 (Nov. 19, 2018). The Commission did not discuss look-through for Rule 606(a) reporting in the Commission’s proposing or adopting release for the 2018 amendments to Rule 606(a). Look-through was instead mandated through FAQs that were published subsequent to the adopting release. “Responses to Frequently Asked Questions Concerning Rule 606 of Regulation NMS,” available at <https://www.sec.gov/tm/faq-rule-606-regulation-nms>.

F. The wording of the proposed rule does not accurately describe what firms are required to report

Even if the Commission determines that it is appropriate to mandate the disclosure of confusing, misleading and non-relevant data to investors and the public, at a minimum the Commission should require that the proposed rule change accurately describe what firms are required to report. The proposed rule change, as presently drafted, does not accurately describe what firms are required to report.

FINRA writes as follows in the FINRA response letter:

... the Proposal is clear concerning the execution venue reporting requirement. As is the case with SEC Rule 606(a), the plain language of proposed Rule 6470(a)(2) requires disclosure of venues to which orders “were routed for execution.” This language is unambiguous—it clearly delineates the venues that must be identified in the disclosure reports to those to which the members’ covered orders were routed “for execution.”¹⁴

The proposed rule requires:

... a discussion of the material aspects of ***the member’s relationship with each venue*** [emphasis added] identified pursuant to paragraph (a)(2) of this Rule, including, without limitation, a description of any arrangement for payment for order flow and any profit-sharing relationship and a description of any terms of such arrangements, written or oral, that may influence a member’s order routing decision....¹⁵

With look-through, FINRA is requiring under certain circumstances that reporting firms report the relationship and financial arrangements ***between the intermediary routing firm and the execution venue***, but this is not what the rule provides. The rule requires “... a discussion of the material aspects of ***the member’s relationship with each venue...***” including “... a description of any arrangement for payment for order flow and any profit-sharing relationship...” There is one problem. In a look-through scenario, there is no relationship or financial arrangement ***between the reporting firm and the execution venue***. If FINRA is requiring disclosure of the financial arrangement ***between an intermediary routing firm and an execution venue*** under certain circumstances, FINRA should revise the proposed rule to clarify this point, including the circumstances under which this reporting would be required.

G. Clarification on the history of Rule 606

FINRA writes in the FINRA response letter that “... Rule 606(a) and its predecessor, Rule 11Ac1-6, have always required disclosure of venues to which customer orders are routed ‘for execution.’”¹⁶ FINRA cites to the 2000 adopting release for 11Ac1-6, the predecessor to Rule 606(a), which provides that the term

¹⁴ FINRA Response Letter, at 5.

¹⁵ FINRA Rule Proposal, at 130-131.

¹⁶ FINRA Response Letter, at 3.

venue "... excludes an entity that is used merely as a vehicle to route an order to a venue selected by the broker-dealer..."¹⁷

In this sentence, the Commission is only excluding a routing firm as a venue when the reporting broker directs the routing firm where to route the order. In other words, under the sentence quoted above, a routing firm can be a venue as long as the routing firm makes the routing decisions. FIF members are not aware of the Commission, prior to the 2018 Rule 606(a) amendments (and even in the Rule 606(a) proposing and adopting releases), ever providing written guidance that a routing firm cannot be an execution venue when the routing firm decides where to route orders for execution. Prior to 2018, many reporting firms reported routing firms (i.e., firms that the Commission would not, based on guidance provided after the 2018 amendments to Rule 606(a), consider to be execution venues for purposes of Rule 606(a)) as execution venues in their Rule 606 reports. This approach made sense for these reporting firms because these reporting firms had a relationship with the routing firm and not with the execution venue.

H. Other concerns with look-through

This letter explains how look-through provides confusing and misleading information to investors and the public and results in the reporting of data that is not comparable across reporting firms. This letter also explains how look-through would remove from the FINRA venues table data that is relevant for investors and the public and replace this with data that is not relevant. In our December comment letter, FIF identified additional concerns with look-through, including the following: a reporting firm is required to report on financial arrangements to which the reporting firm is not a party; there is no obligation under the rule for a routing firm to provide data to a reporting firm; and a reporting firm is limited in its ability to validate the data provided by a routing firm. We also note that look-through creates additional confusion because the Rule 606(a) report involves the reporting of aggregated data and a single row reported for an execution venue could be based on financial arrangements between multiple routing firms and that single execution venue.

I. The proposed rule change does not meet the Commission's standards for approval

As the discussion above demonstrates, the proposed rule change does not meet the Commission's standards for approval. In the Order, "... the Commission invites the written view of interested persons concerning whether the proposal is consistent with Section 15A(b)(6) or any other provision of the Exchange Act, or the rules and regulations thereunder."¹⁸ The Commission states in the Order that Section 15A(b)(6) of the Exchange Act, "... requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest."¹⁹

FIF members address each of these conditions:

¹⁷ Ibid.

¹⁸ Order, at 13.

¹⁹ Ibid.

- ***Preventing fraudulent and manipulative acts and practices.*** The proposed rule change would mandate that misleading information be disclosed to investors and the public.
- ***Promoting just and equitable principles of trade.*** Reporting confusing and misleading information to investors and the public would not promote just and equitable principles of trade.
- ***Protect investors and the public interest.*** Reporting confusing and misleading information to investors and the public would not protect investors and the public interest.

* * * * *

As an implementation-focused industry association, FIF seeks to work cooperatively with, and not in opposition to, the regulators. In connection with this rule filing, where the regulators are proposing a rule change that would be harmful to investors and there is a better approach for investors, it is incumbent upon FIF to express our concerns and our proposed alternative approach.

FIF appreciates the opportunity to comment on SR-FINRA-2022-031 and the Commission's Order. If you would like clarification on any of the items discussed in this letter or would like to discuss further, please contact me at [REDACTED].

Very truly yours,

/s/ Howard Meyerson

Howard Meyerson
Managing Director, Financial Information Forum