

# FINANCIAL INFORMATION FORUM

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## **Via Electronic Delivery**

Mr. Robert W. Errett  
Deputy Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

February 18, 2016

Re: SR-NYSE-2015-46; Release No. 34-76229; Notice of Filing of Proposed Rule Change Establishing Rules to Comply with the Requirements of the Plan to Implement a Tick Size Pilot Plan Submitted to the Commission pursuant to Rule 608 of Regulation NMS under the Act; and Release No. 34-76971, the Securities and Exchange Commission (the "SEC" or "Commission") Order Instituting Proceedings to Determine Whether to Disapprove a Proposed Rule Change to Establish Rules to Comply with the Quoting and Trading Requirements of the Plan to Implement a Tick Size Pilot Plan.

Dear Mr. Errett,

On behalf of Financial Information Forum<sup>1</sup> ("FIF") non-exchange industry members, I am writing to provide additional detail regarding our comment letter of November 5, 2015<sup>2</sup> addressing the New York Stock Exchange (NYSE) rule filing SR-NYSE-2015-46; and, in response to the Commission's request for additional input from commenters to support the analysis of NYSE's proposed rule, specifically with respect to compliance with Section 6(b)(5) and Section 6(b)(8) of the Securities Exchange Act of 1934 (the "Act")<sup>3</sup>. This letter also references FIF's non-exchange industry members' comments<sup>4</sup> regarding SR-FINRA-2015-047 and SR-BATS-2015-108.

FIF will take this opportunity to stress the importance of standardization with regard to all Plan Participants' rules that are ultimately approved by the Commission for implementation of the Tick Size Pilot. It would be unreasonable to expect FIF members to comply with differences across exchanges such as the limitations placed on the displayed quote exception by NYSE's proposed

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<sup>1</sup> FIF ([www.fif.com](http://www.fif.com)) was formed in 1996 to provide a centralized source of information on the implementation issues that impact financial services and technology firms. Our participants include trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues to arrive at productive solutions to meet the requirements of new regulations, technology developments, and other industry changes.

<sup>2</sup> <http://www.sec.gov/comments/sr-nyse-2015-46/nyse201546-1.pdf>

<sup>3</sup> <http://www.sec.gov/rules/sro/nyse/2016/34-76971.pdf> Pursuant to Section 19(b)(2)(B) of the Act, the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the proposed rule change's consistency with Section 6(b)(5) of the Act and Section 6(b)(8) of the Act. Section 6(b)(5) of the Act requires that an exchange's rules be designed, among other things, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and to protect investors and the public interest, and that they not be designed to permit unfair discrimination between customers, issuers, brokers or dealers. Section 6(b)(8) of the Act requires that rules of the exchange not impose any burden on competition that is not necessary or appropriate in furtherance of the Act.

<sup>4</sup> <http://www.sec.gov/comments/sr-finra-2015-047/finra2015047-3.pdf> and <http://www.sec.gov/comments/sr-bats-2015-108/bats2015108-2.pdf>

Rule 67, versus the approach described by FINRA and BATS in their rule filings. In addition, there are other existing rules and guidance that had been provided by regulators prior to the Tick Size Pilot Plan which could present challenges with respect to certain aspects of SR-NYSE-2015-46, SR-FINRA-2015-047, and SR-BATS-2015-108. Several are highlighted within this letter; however, others may be discovered as the Plan is being fully implemented and put into practice.

As stated in FIF's comment letter regarding NYSE's proposal of Rule 67, among our members' primary concerns were the changes to definitions of certain terms such that they are no longer consistent with the SEC Order or the approved Plan as modified, and would result in restrictions on trading centers' activities beyond those contemplated by the Plan. Specifically, our letter highlighted concerns related to: a) retail investor orders; b) displayed quotations; and, c) block size.

#### Retail Investor Orders

The letter submitted to the SEC by NYSE and the Chicago Stock Exchange ("NYSE/CHX Letter"), *Response to Comment Letters Received by the Securities and Exchange Commission Pursuant to Rule Filing SR-NYSE-2015-46 and Comments on SR-BATS-2015-108 and SR-FINRA-2015-047*<sup>5</sup> alleviated the concern regarding "Retail Investor Order", as it was confirmed that the Retail Order Exemption would apply to OTC trading as well as exchange programs, and a Plan amendment would not be necessary for non-exchange trading centers to provide price improvement on orders that meet the Plan definition of a Retail Investor Order.<sup>6</sup> Neither FINRA's or BATS' rule filings reflect the exchange limitation, as both allow Retail Investor Orders to be exempt from the trading provisions when executed internally by a Trading Center. For purposes of the Tick Size Pilot, we ask that NYSE redefine Retail Investor Order and remove the language in its rule that seems to imply an exchange limitation, to ensure that NYSE Rule 67 remains consistent with the Plan and in alignment with the other Plan Participants.

#### Displayed Quotations

NYSE's filing states: "Proposed Rule 67(e)(4)(C) would allow member organizations to execute a sell order for a Pilot Security in Test Group Three at the price of a Protected Bid or execute a buy order for a Pilot Security in Test Group Three at the price of a Protected Offer if any of the following circumstances exist: (A) The order is executed by a Trading Center within a member organization that has a displayed quotation for the account of that Trading Center *on a principal basis*, [emphasis added] via either a processor or an SRO Quotation Feed, at a price equal to the traded-at Protected Quotation, that was displayed before the order was received, but only up to the full displayed size of the Trading Center's previously displayed quote."<sup>7</sup>

The NYSE/CHX letter to the Commission substantiates NYSE's position on limiting the display quotation exemption by describing a "loophole" that it fears could be taken advantage of by ATSS, in particular. The letter speculates that ATSS would begin posting agency quotes to a lit market in order to facilitate price matching. We believe the scenario described is unlikely to occur, as we are not aware of any use cases where an ATS would prioritize a non-displayed order over a displayed order, which is what the "loophole" scenario seems to imply.

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<sup>5</sup> <http://www.sec.gov/comments/sr-nyse-2015-46/nyse201546-5.pdf>

<sup>6</sup> "(DD) 'Retail Investor Order' means an agency order or a riskless principal order originating from a natural person, provided that, prior to submission, no change is made to the terms of the order with respect to price or side of market and the order does not originate from a trading algorithm or any other computerized methodology. The Participant that is the Designated Examining Authority of a member of a Participant operating a trading center executing a Retail Investor Order will require such trading center to sign an attestation that substantially all orders to be executed as Retail Investor Orders will qualify as such under the Plan."

<sup>7</sup> <http://www.sec.gov/rules/sro/nyse/2015/34-76229.pdf> pg. 10.

Because most ATSs operate using an agency business model, under the Tick Size Pilot Plan, ATS orders posted as agent on the ADF (Alternative Display Facility), could become a “Protected Quote”. As such, a potential contra-party would go to the ATS displaying the Best Protected Bid or Best Protected Offer at the time, to execute the trade. NYSE’s proposal to limit the display exception to principal capacity would preclude ATS’ from participating in the market as described, creating a situation that is anti-competitive and contrary to SEA Section 6(b)(8).

Both FINRA and BATS indicate that the display exception applies to trades executed by a Trading Center otherwise than on an exchange, where the Trading Center has previously displayed a quotation in *either an agency, riskless principal or principal capacity*, with the understanding that the details of that exception limits a Trading Center displaying a quotation as agent or riskless principal to execute in that capacity, while a Trading Center displaying a quotation as principal may rely on that displayed quotation to execute in any capacity.<sup>8</sup>

FIF non-exchange members strongly favor the broader, more practical application of the displayed quote exception put forth by FINRA and BATS<sup>9</sup>; and in fact, we believe that approach is necessary for broker dealers to comply with customer obligations and other regulatory requirements. We wish to clarify; however, that even under FINRA’s and BATS’ rules, there are circumstances in which an order posted as agent may need to be filled in a capacity other than as agent, specifically in instances where there are other principal trading activities that could cause the original order to become subject to FINRA Rule 5320.

The following Example 1 provides a use case where certain procedures that, although not in alignment with the proposed Trade-at Prohibition for Test Group Three securities, must be followed to remain in compliance with FINRA Rule 5320.

**Example 1. FINRA Rule 5320 – Customer Limit Order Protection Obligation**

- |   |
|---|
| Market Bid-Ask: 9.95 x 10.00  |
| <ul style="list-style-type: none"><li>• BD receives Customer Buy Day Limit order for 200 shares for 9.95</li><li>• BD sends/posts this 200 share order to an exchange (or ADF) for 9.95 as agent</li><li>• BD receives Customer Sell Day Market order for 10,000 shares and principally fills entire order at 9.95 (relying on the Block Size Exemption)</li><li>• BD owes fill to Customer Buy Day Limit order and provides riskless principal execution at 9.95 (pulling order back from the market at the same time)</li><li>• BD needs to fill customer buy order for 200 shares at 9.95.</li></ul> |

This 200 share fill should be exempt from the Trade at requirement for two reasons: first it is a riskless fill which should be exempt pursuant to similar SEC guidance regarding the trade through requirement of Regulation NMS as noted below. Second, the plan defines "trade at" to "mean[s] the execution by a trading center of a sell order for a Pilot Security at the price of a protected bid or the execution of a buy order for a Pilot Security at the price of a protected offer during Regular Trading Hours."

Therefore, it follows that sell orders filled at the offer and buy orders filled at the bid should not be subject to the Trade-at requirement.

FIF members believe that in every case, broker dealers should be able to cross orders at the protected bid or the protected offer (“at the inside”), without being subject to the Trade-at

<sup>8</sup><http://www.sec.gov/rules/sro/finra/2015/34-76483.pdf> pg. 10; <http://www.sec.gov/rules/sro/bats/2015/34-76552.pdf> pg. 11.

<sup>9</sup> <http://www.sec.gov/comments/sr-finra-2015-047/finra2015047-3.pdf> and <http://www.sec.gov/comments/sr-bats-2015-108/bats2015108-2.pdf>

requirement, both for best execution and FINRA Rule 5320 purposes. A broker dealer is permitted by the Plan to principally fill first the buy(s) at the bid, or the sell(s) at the offer without a Trade-at requirement. The broker dealer may then be required under FINRA Rule 5320 to fill the other side. When the orders on the other side of the market are filled on a riskless basis, FIF further believes that, pursuant to prior staff guidance, those trades "would not constitute a separate transaction".<sup>10</sup>

Since broker dealers are permitted to cross orders in a riskless capacity without being subject to the Trade-at requirement, as noted above, they should also not be prohibited from doing so as agent.

In addition, the sequence in filling the buy and sell orders should not be relevant. To require crosses to be effected only as riskless, or to require that the order being given price improvement be executed first, would be a victory for form over substance and would increase development costs without providing any benefit.

Example 2 demonstrates that it is in customers' best interest for broker dealers when implementing the Tick Size Pilot, to follow FINRA Rule 5320 Order Handling Procedures<sup>11</sup> to reduce the risk of missing the market and provide best execution.

### Example 2. Agency Cross

	<b>Bid Price</b>	<b>Bid Size</b>	<b>Offer Price</b>	<b>Offer Size</b>
NYSE	9.95	200	10.00	100
ARCA	9.95	100	10.05	200
Nasdaq	9.90	100	10.10	300

Customer orders which may interact:

- Firm receives a displayable Customer Buy order for 200 shares at 9.95
- Firm receives a Customer Sell order for 200 shares at 9.95
  
- Firm crosses both orders as Agent at 9.95
- No ISO needed.
- Firm may rely on Order Handling Procedures per FINRA Rule 5320.

FIF members request verification that Example 1 and Example 2 are permitted under the Tick Size Pilot Plan; that is, that broker dealers can when filling orders, principally fill buy orders "at the inside" (customer buys at the Protected Bid), or principally fill sell orders "at the inside" (customer sells at the Protected Offer), or cross those orders with marketable orders on the other side of the market in either a riskless or agency capacity. And, in these instances, the Quote Display Exemption for riskless or agency quotes should not be a factor, since filling these orders on a riskless or agency basis should not be subject to the Trade-at requirement. If the Commission finds that the examples provided are not permitted under the Plan, FIF members believe the Quote Display Exemption should apply as proposed by FINRA and BATS.

<sup>10</sup> SEC guidance on Regulation NMS, FAQ 3.04 related to the second leg of a riskless principal transaction <https://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm>

<sup>11</sup>**FINRA Rule 5320 .07 Order Handling Procedures.** A member must make every effort to execute a marketable customer order that it receives fully and promptly. A member that is holding a customer order that is marketable and has not been immediately executed must make every effort to cross such order with any other order received by the member on the other side of the market up to the size of such order at a price that is no less than the best bid and no greater than the best offer at the time that the subsequent order is received by the member and that is consistent with the terms of the orders.

The above examples also clearly demonstrate a need for harmonization across rules and rulemaking entities. FIF has previously highlighted other Reg NMS exemptions that should be applicable to the Tick Size Pilot in order to avoid confusion and conflict. FIF members had understood that the exceptions to the trade-at provision under the Tick Size Pilot were meant to be closely aligned to the exemptions available for Rule 611 (the trade-through rule) of Regulation NMS.<sup>12</sup> In that spirit, we believe certain exemptions should be referenced in the NYSE, FINRA and BATS rule filings and/or formal regulatory guidance must be provided to assist broker dealers in addressing the challenges of implementation.

Specifically, while not originally in Rule 611, the Commission issued several orders to add Reg NMS trade-through exemptions and provided guidance in the form of FAQs. Therefore, by extension, the Tick Size Pilot should allow the following exemptions to the Tick Size Pilot trade-at provision and that prior guidance should apply:

- Order Exempting Certain Error Correction Transactions from Rule 611 of Regulation NMS under the Securities Exchange Act of 1934 <http://www.sec.gov/rules/exorders/2007/34-55884.pdf>
- Order Exempting Certain Print Protection Transactions from Rule 611 <http://www.sec.gov/rules/exorders/2007/34-55883.pdf>
- SEC guidance on Regulation NMS, FAQ 3.04 related to the second leg of a riskless principal transaction <https://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm>

#### Block Size Exemptions

The NYSE filing, as well as the FINRA and BATS filings, have redefined the criteria for a block size order by introducing qualifiers to the block size trade-at exemption that do not exist in either the SEC Order or the approved Plan. Stipulations have been added such that, in order to utilize the block size trade-at exemption:

- “(C) The order is of Block Size at the time of origin and may not be:
- (i) an aggregation of non-block orders;
  - (ii) broken into orders smaller than Block Size prior to submitting the order to a Trading Center for execution; or
  - (iii) executed on multiple Trading Centers”<sup>13</sup>

We understand this has been added to ensure the purpose of the trade-at prohibition is not undermined; however, this will prevent a trading center from facilitating a trade that includes smaller orders. These limitations placed on current trading behaviors may ultimately disadvantage customers’ ability to get best execution. Example 3 describes the scenario.

#### **Example 3. Block Size Aggregation**

- BD receives multiple customer orders (less than block size) to Buy a security and is actively working on getting executions
- BD receives a single block size order to Sell the same security and would like to principally facilitate this block transaction at the prevailing offer price
- BD wants to incorporate existing Buy orders into the overall block transaction even though they are less than block size individually  
BD should not be prevented from filling existing Buy orders at block transaction price although not in alignment with the proposed Trade-at Prohibition for Test Group Three securities.

<sup>12</sup> <https://www.sec.gov/rules/sro/nms/2015/34-74892.pdf> pgs. 94, 106. “the Commission expects that market participants would be able to leverage existing Rule 611 systems for implementing and complying with the Tick Size Pilot”

<sup>13</sup> <http://www.sec.gov/rules/sro/nyse/2015/34-76229.pdf> pg.11.

FIF suggests that aggregation of non-block orders be permitted as long as at least one side of the block cross in itself would constitute a “block size order” by the definition stipulated in the approved Plan; that is, “an order (1) of at least 5,000 shares or (2) with a market value of at least \$100,000 will be considered a block size for purposes of the Tick Size Pilot.”<sup>14</sup>

In its Order Approving the National Market System Plan to Implement a Tick Size Pilot Program on May 6, 2015, the Commission indicated it is not their intent that transactions not likely to occur on exchange should migrate to exchanges as a result of the Trade-At Prohibition.<sup>15</sup> We believe this applies to block crosses, which are commonly facilitated today and can provide added liquidity to less liquid securities. More generally, each of the examples above represent standard OTC transactions which are aimed at achieving best execution for the customer.

Outstanding Issues Prevent Proper Analysis and Coding

There are many mission-critical issues that must be resolved specific to the Trade-at provision, and a better understanding is also needed of certain situations where customers may, or may not, submit orders or be executed in increments other than \$ .05. Unanswered questions and unresolved issues are preventing the broker dealers from moving forward with key aspects of development. This is problematic given the October 3, 2016 effective date for implementation of the full Pilot.

Example 4 demonstrates but one situation where broker dealers are quite unsure of their obligations for Group Three Pilot securities subject to the Trade-at Prohibition. The following poses a scenario where the order size is smaller than the displayed size of the NBBO/PBBO.

**Example 4. Order Size Smaller than Displayed Size of the NBBO/PBBO**

- Broker Dealer receives order to Sell 300 shares of XYZ and wants to fill at current Bid
- Snap shot at time of order receipt is as follows:

MPID	Size	Bid	Ask	Size	MPID
NYSE	100	10.05	10.15	200	NSDQ
BATS	100	10.05	10.15	100	BATS
NSDQ	200	10.05	10.25	5000	NYSE
ARCA	500	10.00	10.25	5000	ARCA
CHI	500	9.95	10.25	1000	CHI

- We assume that, based on the “snap,” ISOs are routed up to the size of the order in hand to meet the “Trade-At” obligation; however, the specific venues to which the ISOs must be routed is unclear.
- The requirements are also unclear if some portion or all the ISOs are rejected (e.g. 100 filled and 200 rejected); however, FIF members assume the Tick Size requirements remain consistent with Rule 611.

There will also be instances where a broker dealer will send an oversized ISO order to an exchange, either because the size of the protected quote at the exchange decreased between the time the broker submitted the order and the time it arrived at the exchange, or because the broker wanted to try to sweep up any non-displayed interest at a given price level. We are unclear how an exchange would handle an oversized ISO order submitted by a broker under the Trade-at rule, in cases where

<sup>14</sup> <https://www.sec.gov/rules/sro/nms/2015/34-74892.pdf> pg.104.

<sup>15</sup> Ibid. pg. 97. “... the Trade-At Prohibition should not result in a migration to exchanges of transactions not likely to occur on exchanges in the Control Group.”

an exchange's order book contains both displayed and non-displayed interest at the price of its protected quote. FIF members believe the rules with regards to non-displayed liquidity should be consistently applied to both on-exchange and off-exchange trading.

These are but two of the many critical scenarios where the rules are unclear and trading centers will require definitive guidance from the Commission and Plan Participants in order to complete analysis and development.

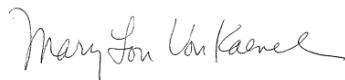
In summary, FIF wishes to reiterate our concern that all rules and regulatory guidance be harmonized to reflect the principals that are applied to existing trading practices as well as those being introduced by the Tick Size Pilot. Additionally, we expect that any requirements and limitations will be removed from these proposed rules where they are not consistent with the Order, the approved Plan, or SEA Section 6(b)(5) and Section 6(b)(8); as we are confident the Commission will ensure any rules imposed by the Pilot are not likely to disadvantage customers or impede fair competition. Equally important, as many of the outstanding issues are fundamental to the entire process, it is imperative that these rules and requirements are finalized and well understood by all market participants to ensure they are properly and consistently implemented.

Also at this time, FIF respectfully requests that the Commission formally suspend the October 3, 2016 effective date for the start of the Pilot, and refrain from establishing a new date until all rule filings have been harmonized, finalized, and unanswered questions have been resolved. Significant coding and testing is involved to implement these very complex rules, including changes to customer interfaces and numerous internal order handling, order routing and execution systems. Changes made for Tick Size Pilot will impact existing processes that handle all current NMS quoting and trading activities. Assuming the final Plan Participants' rules for quoting and trading are in alignment with existing regulations (e.g. FINRA 5320), we currently estimate the Pilot phase will require a bare minimum of six months of programming and testing; however, the effort could be greater if the final requirements introduce unexpected complexities. Without sufficient time to properly code for Tick Size Pilot and complete regression testing, our current NMS programs could be placed at risk.

Thank you for the opportunity to submit these comments. We remain hopeful that our recommendations will be considered and incorporated in the final rules and guidance related to the Tick Size Pilot; and, that we be given a reasonable and realistic timeframe for implementation following approval of the final rules.

Please do not hesitate to contact me at [REDACTED] with questions or to arrange for follow up discussions. Thank you for your consideration of these critical industry issues.

Regards,



Mary Lou Von Kaenel  
Managing Director  
Financial Information Forum

cc: The Honorable Mary Jo White, Chair  
The Honorable Michael S. Piwowar, Commissioner  
The Honorable Kara M. Stein, Commissioner  
Stephen Luparello, Director, Division of Trading and Markets  
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