

FINANCIAL INFORMATION FORUM

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New York, New York 10005

212-422-8568

January 30, 2019

Mr. Brett Redfearn
Director, Division of Trading and Markets
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Request for Comment – FIF Rule 605 Modernization Recommendations

Dear Mr. Redfearn,

On behalf of the members of the Financial Information Forum's ("FIF")¹ SEC Rule 605 Working Group ("Working Group"), we would like to thank you and your Staff for meeting with us on October 30, 2018, to discuss our Recommendations for Modernizing SEC Rule 605. As a follow-up to this meeting, the Working Group members met to discuss potential next steps in light of Staff and Commission feedback regarding current regulatory priorities. As such, we recommend that the SEC use the presentation we shared at the meeting (provided in Appendix A) as the basis for issuing a public Request for Comment to Modernize SEC Rule 605. In this fashion the Commission can move forward on this topic by gathering additional information, as well as asking the industry for input several questions raised by Trading & Markets Staff during our meeting.

Background

In January of 2018, FIF formed a Working Group comprised of industry-leading Retail Broker-Dealers, Whole Broker-Dealers, and a third-party analytics provider to review the historical reporting requirements of Rule 605. The goal of the Working Group was to determine whether enhancements/updates should be considered to more accurately reflect the current market structure, which include substantial changes to trading technology (*i.e* enhanced routing technology and novel trading strategies derived from changes in technology), greater focus on self-directed trading by investors, and unprecedented access to the markets.

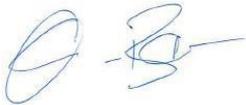
As many self-directed investors and their Broker-Dealers rely on standardized third-party 605 reports (and/or information derived from those reports) to inform on how they direct their order flow, FIF believes that the Commission should consider revising current Rule 605 to more accurately reflect the best practices developed by industry participants in the intervening years following the adoption of Rule 605.

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 trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

Specifically, FIF believes that the scope of covered orders and the granularity of reporting pursuant to Rule 605 should be expanded to better reflect current market structure. Additionally, FIF believes that the creation of a “Marketable Benchmark” statistic should be incorporated into Rule 605 reports that will better inform investors of the size of the order relative to the consolidated NBB/NBO. In a similar vein, FIF believes that the creation of a “Non-Marketable Benchmark” should be considered to better allow investors transparency into the number of shares executed in the market while the NMLO was in force and at prices that could have filled the NMLO. FIF believes that these proposed enhancements more accurately reflect current market structure and will better provided investors with the transparency required to make informed decisions regarding how they direct their order flow.

FIF wishes to thank the Commission for considering the Working Group’s Rule 605 Modernization recommendations and our request that the recommendations appended in Appendix A provide the basis for a request for public comment. Please feel free to contact me at 212-652-4485 to further discuss the recommendations.

Regards,

A handwritten signature in blue ink, appearing to read 'C. Bok', with a stylized flourish extending to the right.

Christopher Bok
Financial Information Forum

CC: David Shillman, Associate Director, Division of Trading and Markets, SEC
Daniel Gray, Senior Special Counsel, Division of Trading and Markets, SEC

Appendix 1

Why Update Rule 605?



- In 2018 FIF formed a Working Group composed of leading retail broker-dealers, wholesale broker-dealers, and a third-party analytics provider, to review the reporting requirements of Rule 605 (initially codified in November, 2000) to determine whether updates are needed to better reflect nearly two decades of market evolution.
- Since the original rule, the markets have undergone many changes, such as: Reg NMS; the advent of smart order routing technologies; and the ready-availability of web-based trading providing self-directed trading by investors (“self-directed investors”) with unprecedented access to the markets. As a result the self-directed investor environment has evolved to include a wide range of market participants and activities, from occasional trading by small investors to very active-traders.
- Since many market participants, especially those serving self-directed investors, rely on *Standardized, Third-Party 605 Reports* (or information derived from those reports) to direct their order flow, FIF believes that Rule 605 could be beneficially updated to reflect various best practices developed by industry participants in recent years.
- FIF is recommending that Rule 605 be updated to provide further enhancements to 605 coverage, data, and reported metrics so that the quality of executions resulting from different types of trading activities can continue to be accurately and objectively evaluated.

Expand the Scope of Covered Orders



Recommendations for the SEC's Consideration:

- 1. Include customer orders of less than 100 shares:** Odd-lots represent close to 50% of self-directed orders and are currently out of view from public data (IHS Markit Analysis of Q1 2018)
- 2. Include away-from-the-quote Non Marketable Limit Orders ("NMLOs") (currently limited by rule to within 10 cents of NBBO):** The current framework excludes many orders set with a specific price target outside the 10 cent threshold. Adding an additional "away-from-the-quote" bucket for NMLOs would capture a significantly greater number of self-directed orders from individual investors.
- 3. Include all NMLO orders that can be executed during normal market hours instead of restricting to only orders entered post 9:30 EST:** Self-directed investors often enter their price target limit orders before the market opens even if the price happens to be within 10 cents of the opening NBBO. In addition orders can be entered GTC so the time frame can span multiple days.
- 4. Create a new order size bucket for shares of 10,000 or more but cap all buckets at \$500K notional:** Large-share orders are an increasingly important aspect of the individual investor eco-system. Including large-share orders in 605 reports will provide important transparency to this segment of activity. To prevent very large-size orders from skewing the results (as noted in the original no-action relief that create the 10,000-share cap), 605 orders will instead be capped by notional value of \$500,000.
- 5. Include short sale orders:** Current guidance excludes all short-sale orders from 605 due to uptick rules that are no longer in effect.



Recommendations for the SEC's Consideration:

1. **Separate IOC orders within Rule 605 statistics:** Immediate or cancel ("IOC") orders have a different profile and can skew execution quality statistics.
2. **Add notional buckets as an additional method of categorization:** Rule 605 currently requires orders to be bucketed by share size. However, it is not very meaningful to compare execution quality of a 500 share order in a \$2 stock with a 500 share order for a \$200 stock. Notional buckets would allow for an additional, and potentially more meaningful, metric to compare execution quality. Based on an aggregate analyses of Q1 2018 retail/wholesale order flow by IHS Markit, we recommend the following notional buckets:
 - \$1 - \$999 (33%)
 - \$999 - \$4,999 (29%)
 - \$5,000 - \$19,999 (24%)
 - \$20,000 - \$49,999 (8%)
 - \$50,000 – \$500,000 (6%)
3. **Change time-to-execution buckets :** The current time bucketing is outdated. Instead of the bucketing, provide average execution time for marketable orders, measured in milliseconds (or microseconds). Eliminate execution-time statistics for marketable limit orders that exceed the consolidated quote size, or may become non-marketable for other reasons (e.g. Limit-Up/Limit-Down) (since marketable limit orders may be partly executed, it is difficult to interpret data that combines both time-of-execution for the marketable and non-marketable parts).



Recommendation for the SEC’s Consideration:

- For marketable orders, add a new “*Marketable Benchmark*” statistic that informs on the size of the order relative to the consolidated (protected) NBB/NBO: Rule 605 requires the calculation of price improvement data relative to the quote without regard to the size available. For orders smaller than the displayed size at NBO or NBB this produces a meaningful measure of execution quality. However, for orders that outsize the displayed size this produces a distorted metric. Adding a *Marketable Benchmark* statistic, defined on a per-order basis as:

$$\text{Marketable Benchmark} = \text{Min} (\text{Consolidated Quote} , \text{Covered Shares})$$

to the list of 605-Reported fields provides users with a way of benchmarking their executions based on the size of a buy (or sell) covered order relative to the size of the consolidated NBO (or NBB) at the time the order was placed.

- Adding *Marketable Benchmark* as a new statistic requires whoever is producing the 605 Report to also record the size of consolidated NBO/NBB as well as the price at the NBO/NBB (as is done today). However, consolidated size is only used internally to compute the *Marketable Benchmark* statistic. It would not be a separate field, and would not be included in 605 Reports.
- As shown on the next page, recipients of 605 Reports would be able use the new *Marketable Benchmark* statistic to derive their own additional measures of execution quality at any level of aggregation, such as “Enhanced Shares,” or “Enhanced Share Rates.”

Marketable Benchmark Examples



Total Covered Shares	Current 605-Reported Fields				NEW 605 FIELD		Publicly Derivable*		Privately Derivable**
	Price-Improved Shares	At-the-Quote Shares	Outside-the-Quote Shares	Cancelled Shares	Consolidated Reference Quote Size	Marketable Benchmark	Enhanced Shares	Size Enhancement Rate	Order vs Consolidated Quote Size
500	0	500	0	0	2,000	500	0	0%	<=touch size
500	500	0	0	0	2,000	500	0	0%	<=touch size
2,000	0	2,000	0	0	2,000	2,000	0	0%	<=touch size
3,000	0	2,000	1,000	0	2,000	2,000	0	0%	1-2X touch
3,000	500	1,500	1,000	0	2,000	2,000	0	0%	1-2X touch
3,000	1,000	1,500	500	0	2,000	2,000	500	25%	1-2X touch
3,000	1,500	1,500	0	0	2,000	2,000	1,000	50%	1-2X touch
4,000	500	1,000	2,500	0	2,000	2,000	-500	-25%	2-5X touch
4,000	0	1,000	1,500	1,500	2,000	2,000	-1,000	-50%	2-5X touch
5,000	0	5,000	0	0	2,000	2,000	3,000	150%	2-5X touch
8,000	1,000	5,000	2,000	0	2,000	2,000	4,000	200%	2-5X touch
36,000	5,000	21,000	8,500	1,500		19,000	7,000	37%	All

* The **Enhance Shares/Rates** fields can be derived from the **Marketable Benchmark** field and provide 605-Report users with an additional way of measuring execution quality based on the extent to which a venue has provided liquidity above and beyond what was available at the NBB/NBO

- **Enhanced Shares** = Price-Improved Shares + At-the-Quote Shares – Marketable Benchmark
- **Size Enhancement Rate** = Enhanced Shares / Marketable Benchmark

** The **Order vs Consolidated Quote Size** fields represent an additional method of bucketing and grouping orders for those with access to the individual orders composing a 605 Report, or to a reporting tool that dynamically buckets individual orders.



Recommendation for the SEC’s Consideration:

- For NMLOs add new “Non-Marketable Benchmark” statistics that inform on the number of shares executed (regular way) in the market while the NMLO was in force and at prices that could have filled the NMLO: Evaluating and comparing the execution quality of NMLOs can be challenging since the probability of execution is often driven by market conditions while the order is in force. *Non-Marketable Benchmark* statistics provide a reference for evaluating the extent to which an NMLO could have been filled. This is particularly important for NMLOs priced away-from-the-quote, since market conditions may prohibit them from ever being filled.
- There are two variations of these new statistics reflecting two different benchmarks:
 - The *Non-Marketable Benchmark (Exchange)* statistic only considers shares executed on NMS-exchanges at prices that could have filled the NMLO while it was in force.

Non-Marketable Benchmark (Exchange) = Min (NMS-Exchange Prints , Covered Shares)

- The *Non-Marketable Benchmark (Total)* statistic considers shares executed on NMS-exchanges, as well as regular-way off-exchange executions reported to the TRFs, at prices that could have filled the NMLO while it was in force.

Non-Marketable Benchmark (Total) = Min (All Prints , Covered Shares)



- Adding these *Non-Marketable Benchmarks* as new statistics requires whoever is producing the 605 Report to also separately record the total number of shares executed on-exchange and off-exchange at prices that could have filled the NMLO while it was in force. However, this data is only used internally to compute the *Non-Marketable Benchmark* statistics. They are not separate fields, and would not be included in 605 Reports.
- As shown on the next page, recipients of 605 Reports would be able to use these new *Non-Marketable Benchmark* statistics to more fully evaluate the execution quality of non-marketable limit orders by deriving fill rates based on realized market conditions, in addition to simply computing an absolute fill rate. The examples shown only represent two of many variations that could be computed from these new statistics.

Non-Marketable Benchmark Examples



Current 605-Reported Fields			Internal		NEW 605 FIELDS		Publicly Deriveable		
Total Covered Shares	Total Executed Shares*	Cancelled Shares	Exchange Prints	TRF Prints	Non-Marketable Benchmark (Exchange)	Non-Marketable Benchmark (Total)	Absolute Fill Rate	Benchmark Fill Rate (Exchange)	Benchmark Fill Rate (Total)
3,000	3,000	0	5,000	1,000	3,000	3,000	100%	100%	100%
5,000	5,000	0	5,000	1,000	5,000	5,000	100%	100%	100%
6,000	5,000	1,000	5,000	1,000	5,000	6,000	83%	100%	83%
6,000	6,000	0	5,000	1,000	5,000	6,000	100%	120%	100%
8,000	4,000	4,000	5,000	1,000	5,000	6,000	50%	80%	67%
8,000	5,000	3,000	5,000	1,000	5,000	6,000	63%	100%	83%
8,000	6,000	2,000	5,000	1,000	5,000	6,000	75%	120%	100%
10,000	6,000	4,000	5,000	1,000	5,000	6,000	60%	120%	100%
10,000	2,000	8,000	0	2,000	0	2,000	20%	N/A	100%
10,000	0	10,000	0	2,000	0	2,000	0%	N/A	0%
10,000	0	10,000	0	0	0	0	0%	N/A	N/A
84,000	42,000	42,000			38,000	48,000	50%	111%	88%

- **Absolute Fill Rate** = Total Executed Shares / Total Covered Shares
- **Benchmark Fill Rate (Exchange)** = Total Executed Shares / Non-Marketable Benchmark (Exchange)
- **Benchmark Fill Rate (Total)** = Total Executed Shares / Non-Marketable Benchmark (Total)

* Total Executed Shares is not explicitly reported on current 605 Reports, but is simply the sum of two fields that are explicitly reported: Market Center Executed Shares and Away Executed Shares.

Review “Realized Spread” Statistic



Recommendation for the SEC’s Consideration:

- **Review (eliminate) use of Realized Spread:** This metric has questionable value for held orders where a client has explicitly determined to execute a trade either immediately (for marketable orders) or as soon as the prevailing market reach the order’s limit price (for non-marketable orders). If the statistic is to remain, determine an appropriate time-scale for the measurement, or re-affirm the current 5-minute duration.