

FINANCIAL INFORMATION FORUM

March 31, 2023

By electronic mail to rule-comments@sec.gov

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

Re: File Number S7-31-22: Order Competition Rule

Dear Ms. Countryman,

The Financial Information Forum (“FIF”)¹ appreciates the opportunity to comment on the recent Order Competition Rule proposal issued by the Securities and Exchange Commission (the “Commission”)². Given the diverse business models of FIF member firms and the implementation focus of FIF, we are not commenting on the policy aspects of the rule proposal. Our comments are focused on the mechanics of the rule proposed by the Commission (the “proposed rule”), indicating issues and workflows where further guidance is required. This comment letter also discusses implementation issues. We submit these comments on behalf of FIF members that are broker-dealers and technology vendors.

As discussed in further detail below, the proposed rule in its current form is unworkable. It requires clarification and deconfliction with a number of existing rules and practices.

Further, FIF members believe that there is significant risk of unintended consequences if the proposed rule is approved without first observing the effects of the other rules simultaneously proposed by the Commission on December 14, 2022.³ It is extremely difficult to evaluate or predict the myriad, compounding effects of four significant and inter-related rule proposals without understanding which

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. 96495 (Dec. 14, 2022), 88 FR 128 (Jan. 3, 2023) (Order Competition Rule) (“Proposing Release”).

³ Securities Exchange Act Release No. 96493 (Dec. 14, 2022), 88 FR 3786 (Jan. 20, 2023) (Disclosure of Order Execution Information). Securities Exchange Act Release No. 96494 (Dec. 14, 2022), 87 FR 80266 (Dec. 29, 2022) (Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders). Securities Exchange Act Release No. 96496 (Dec. 14, 2022), 88 FR 5440 (Regulation Best Execution).

proposals will be adopted and in what sequence or timeline. FIF members concur with the recommendation in the comment letter (on these four rule proposals) jointly submitted by NYSE Group, Inc., Charles Schwab & Co., and Citadel Securities on March 6, 2023⁴ that the Commission should postpone further consideration of the Order Competition Rule proposal until the effects of the proposed tick size and Rule 605 changes are implemented, and ample time is allowed to fully evaluate their effects. Then, if the Commission still feels that an Order Competition Rule is necessary, it must be re-evaluated in light of the new market conditions at that time, which we expect to be significantly different from today; and any re-proposed rule should take into account the extensive questions and challenges that we will explain below.

Deconfliction issues

There are at least four deconfliction issues that we observe to be “primary” among our concerns, where the proposed rule appears to conflict with various Commission and FINRA order handling requirements.

- First, it is not clear how a firm could submit a marketable order to an auction without the risk of being in violation of FINRA Rule 5310, Supplementary Material .01, which requires a firm to “... make every effort to execute a marketable customer order that it receives fully and promptly.”⁵
- Second, it is not clear how a firm could submit a “held” order to a qualified auction.
- Third, it is not clear how a firm could comply with its obligations under FINRA Rule 5320, Supplementary Material .07, which requires a firm, under certain conditions, to cross a marketable order against an opposite-side order received by the firm,⁶ without the firm violating the crossing restrictions of the proposed rule.
- Fourth, there are scenarios where the requirements of the proposed rule would conflict with a firm’s obligations under FINRA Rule 5320(a) (often referred to as the Manning rule).⁷

Given the FINRA requirement that a marketable order be executed promptly, and given the Commission’s guidance on held orders, there are questions as to whether an originating broker could feasibly submit a marketable order to a qualified auction. If these questions are not addressed, 95.3% of customer orders that are currently routed to market makers could not be submitted to a qualified auction.⁸ More generally, any reissued rule proposal should address the potential conflicts above and potential conflicts with any other Commission or FINRA rule.

Qualified auction facility implementation questions

The proposed rule includes no discussion of the approval process for a qualified auction facility; nor is there provision of advance notice to provide industry members with sufficient time to update their systems in response to the technical requirements and trading rules of a new qualified auction facility.

⁴ Available at <https://www.sec.gov/comments/s7-31-22/s73122-20158677-326603.pdf>.

⁵ Available at <https://www.finra.org/rules-guidance/rulebooks/finra-rules/5310>.

⁶ Available at <https://www.finra.org/rules-guidance/rulebooks/finra-rules/5320>.

⁷ Ibid.

⁸ See Proposing Release, at 362.

The proposed implementation requirements, process and timetable should be discussed in any reissued rule proposal. Given the complexity and novelty of the proposed rule, and its prescriptive routing requirements, the mere existence of each new exchange auction mechanism could put significant demands on industry firms, and therefore these questions of notice and timelines must be considered carefully.

Detailed questions

In addition to the concerns above, there are a number of additional aspects of the proposal where additional clarification is required, including the following (each of these items is discussed in detail below):

- The scope of what constitutes a segmented account
- Whether aggregation of accounts is required when determining whether an account is a segmented account
- The time period for updating account classifications
- Determining the broker that has the responsibility to determine whether an account is a segmented account
- Application of the rule to orders from non-U.S. customers
- Application of the rule to orders for inter-listed securities
- Whether a firm can submit an order that is not a segmented order to a qualified auction
- Executing a segmented order against an order displayed on a continuous order book
- How an open competition trading center (“OCTC”) would systematically communicate its qualified auction terms to market participants
- Why the Commission does not propose exceptions for orders that are large relative to ADV, not held orders (including VWAP orders), orders that outsize the market, and directed orders
- The option for an OCTC to refrain from operating multiple simultaneous auctions
- How to ensure that a qualified auction facility has sufficient capacity to handle segmented orders that are submitted to the facility
- Whether a firm submitting a segmented order to a qualified auction facility would be permitted to specify a minimum execution size (such as a round lot)
- Which actions are permitted and not permitted after an unsuccessful auction
- How the rule would apply when a child route is submitted to a qualified auction facility
- The ability for firms to submit auction responses that apply to multiple auctions
- Whether an OCTC could permit an auction responder to specify a minimum execution size (such as a round lot) in its response
- Whether an OCTC could establish procedures whereby opposite-side segmented orders could interact with each other
- Whether an OCTC could permit an auction responder to submit a pegged auction response as opposed to an auction response with a fixed price
- The process for an OCTC to set the auction period
- The ability to cancel a segmented order that was submitted to a qualified auction

- The ability to cancel an auction response
- The categories of participants that an OCTC is permitted to prioritize (apart from the rules of priority mandated in the proposed rules)
- How an OCTC is permitted to prioritize responses that are within the same level of priority under the proposed rule
- How an OCTC, when prioritizing auction responses, would know whether a response represents a customer order or a broker-dealer order
- How an OCTC would know whether the routing parties (direct and indirect) for a segmented order that is submitted to and executed in a qualified auction and a responding counter-party are affiliates
- How a firm with an opposite-side customer order to a segmented order could comply with the requirements for non-attribution
- How a firm with separate desks could comply with the requirements for non-attribution
- How an originating broker could prevent a downstream firm in the order handling process for a segmented order from responding to an auction for that segmented order
- How a firm involved in the order handling process for a segmented order, other than the firm that directly submits the segmented order to a qualified auction, could know whether or not a specific auction relates to that segmented order
- Determining which firm should be attributed as the originating broker for a segmented order
- The prohibition against a broker-dealer submitting a segmented order to a qualified auction facility having priority to trade against that segmented order
- The prohibition against an exchange operating a facility that could execute a segmented order given that a segmented order can execute on an exchange limit order book
- Execution by an alternative trading system (“ATS”) at the mid-point based on when the order is received by the ATS
- How auction fees would apply in certain scenarios, including scenarios where an OCTC could be required to pay both sides to a trade
- Whether and how the Commission’s Order Protection Rule would apply in certain scenarios
- Whether ISOs (intermarket sweep orders) would be required in certain scenarios and how this would be applied
- How trading halts, limit up-limit down scenarios and circuit breakers would impact qualified auctions
- How a firm could process an error correction without violating the order competition requirement
- How a firm could process a fractional share order off-exchange without violating the order competition requirement
- How a firm could execute a fractional share order through a qualified auction facility operated by an exchange given that there would be no mechanism for settling the resulting trade
- How a firm could execute a multi-leg order without violating the order competition requirement
- How a firm could execute a contingent or paired order without violation the order competition requirement

- Whether a qualified auction facility could operate outside of regular trading hours and at the open and close of trading
- If a qualified auction facility could operate at the open and close of trading, how the current exchange opening and closing auctions would be impacted
- How a firm is expected to handle a customer limit order that is not executed in an opening auction
- Surveillance requirements arising from the proposed rule
- How CAT, Rule 605 and other regulatory reporting would be impacted by the proposed rule and how the timing of these changes would be coordinated with the implementation of qualified auction facilities.

While the comments in this letter are limited to implementation and workflow issues, FIF members have concerns about the potential adverse policy impacts of the proposed rule. FIF members are addressing these concerns through comment letters submitted by other industry associations and through individual firm comment letters.

The comments below are generally ordered based on the order in which the associated topic is presented in the Commission’s proposing release for the proposed rule (the “proposing release”). In this letter, we use the term “order competition requirement” to refer to the obligation of a restricted competition trading center (“RCTC”) to submit a segmented order to a qualified auction if no applicable exception under the rule applies.

A. Segmented orders

The Commission should define a segmented account

The rule proposal defines a “segmented order” as “... an order for an NMS stock that is for an account: (i) Of a natural person or an account held in legal form on behalf of a natural person or group of related family members; and (ii) In which the average daily number of trades executed in NMS stocks was less than 40 in each of the six preceding calendar months.”⁹ We refer to the threshold in clause (ii) as the “active account threshold”.

The way that “segmented order” is defined in the proposed rule can cause confusion because segmentation, as defined in the proposed rule, is an account-level attribute, and not an order-level attribute. In other words, to determine whether an order is segmented, a firm does not need to know anything about the order (except that it is for an NMS stock); instead, the firm needs to know specific information about the account. To provide greater clarity, the Commission should first define a “segmented account” (based on the characteristics of the account) and then define a segmented order as an order in an NMS stock that is for a segmented account. In this comment letter, we use the term “segmented account” in accordance with this definition. This will enhance the clarity of our comments below.

⁹ Proposed Rule 600(b)(91); Proposing Release, at 391.

The proposed “look-through” requirement in the definition of segmented order would impose an undue burden on industry members

The proposed definition of segmented order requires “look-through”. With look-through, it is not sufficient for a firm to consider whether an account is in the name of an entity or one or more natural persons; instead, if the account is in the name of an entity, the firm must “look-through” the entity to analyze the holders of the account. FIF members recommend, as an alternative, that a firm classify an account as segmented based on whether the account is in the name of a natural person or a legal entity. More specifically, an account in the name of one or more natural persons where the account is below the active account threshold would be a segmented account, while other accounts would not be segmented accounts.

Because of the look-through requirement, the proposed definition of segmented order is too broad and would impose an undue burden on industry members. The first prong of the proposed definition of “segmented order” provides that a segmented order is an order for an account “... of a natural person or an account held in legal form on behalf of a natural person or group of related family members...”¹⁰ The Commission states that this prong of the definition is similar to the definition of “retail” orders as applied for various exchange retail liquidity programs and the definition of “retail orders” in FINRA’s fee schedule for the Nasdaq Trade Reporting Facility (“TRF”).¹¹ The Commission further states that “[T]his would help reduce the costs of compliance because broker-dealers would already be familiar with identifying orders as for the accounts of natural persons, or for related accounts, in these other contexts.”¹² FIF members disagree with this assertion because the Commission omits one very important distinction: an originating broker can elect whether or not to include specific accounts in a retail liquidity program and can similarly elect, with respect to the TRF fee schedule, whether or not to qualify for the reduced reporting fees that apply to a “Retail Participant”.¹³ For example, an originating broker can elect only to include in a retail liquidity program orders for accounts that are held in the name of one or more natural persons. In doing so, the originating broker is not required to verify whether the account holders of a legal entity account are related family members. In contrast, under the proposed rule this would become a mandatory compliance obligation.

There are two additional points that are important to highlight with respect to the fee exemption for Retail Participants in the TRF fee schedule. First, this fee exemption provision is only applicable to a firm where “... substantially all of its trade reporting activity on the FINRA/Nasdaq Trade Reporting Facility comprises Retail Orders.”¹⁴ This means that most firms are not impacted by this provision. Second, even for the minority of firms that could qualify as a Retail Participant, if the firm can confirm that

¹⁰ Ibid.

¹¹ Id. at 78-79.

¹² Id. at 79.

¹³ FINRA Supplementary Material 7620A.01, available at <https://www.finra.org/rules-guidance/rulebooks/finra-rules/7620a>.

¹⁴ Ibid.

substantially all of its accounts are in the name of a natural person, there would be no need for the firm to analyze the remaining accounts that are in the name of a legal entity.

To comply with the proposed look-through requirement, every broker-dealer would need to obtain certification for every account that is in the name of a legal entity as to whether or not the account meets the condition of the first prong of the definition of segmented order. The definition would be confusing for customers to understand and for firms to apply. For example, as proposed, a natural person who is not a relative but shares a household is considered a family member, except if the natural person is a tenant or employee. What does it mean to be a tenant? What if the natural person does not contribute to the rent but contributes through other means, such as by sharing in the food costs for the household? What if the natural person does not contribute cash but provides services for the household (such as, walking the dog)? Would a firm need to obtain a “segmented account” certification from a representative for any account that is not in the name of a natural person prior to permitting any trading activity in the account? What would be the required frequency for firms to update this certification? Would firms be entitled to rely on certifications provided by a person establishing the account, or would firms be obligated to conduct an independent verification of this certification? Would firms be obligated to impose on their customers an obligation to update their “segmented account” certification every time there is a change in status? Given the significant burden that would be imposed on customers and firms as a result of the look-through obligation included in the rule proposal, FIF members recommend the more straightforward approach proposed above under which a firm would classify an account based on whether the account is in the name of one of more natural persons or a legal entity.

The proposed “look-through” requirement would capture certain institutional accounts that should not be classified as segmented accounts

The “look-through” requirement in the proposed definition of segmented order would capture certain institutional accounts. Specifically, if an investment management firm, such as a hedge fund, is wholly-owned by a single natural person or a group of related persons, and the activity in an account of the investment management firm held at an originating broker does not exceed the active account threshold, the account would be a segmented account, and the order competition requirement would apply. Based on the understanding of FIF members (please see further discussion below), all orders by this investment manager would be considered segmented orders even if the investment management firm is allocating trades to third-party sub-accounts that could be large institutional accounts. Also, as discussed in further detail below, originating brokers and other parties routing and executing orders for these institutional accounts would not be able to opt-out of the order competition requirement for these orders. In many cases, this will result in adverse price impact for these institutional orders, as there are many orders below \$200,000 in notional value that can incur significant price impact. FIF members assume that it is not the Commission’s intent to apply the order competition requirement to institutional accounts.

FIF members request clarification on how “look-through” would apply in scenarios that involve three or more natural person owners of a legal entity

The first prong of the definition of a segmented orders provides that the order is for an account “... [O]f a natural person or an account held in legal form on behalf of a natural person or group of related family members.”¹⁵ As proposed by the Commission, “related family members” include certain persons who have ownership in the legal entity and share a residence with other owners of the legal entity even if the parties are not related.¹⁶ Assume that a firm opens an account for an LLC. If the members (i.e., owners) of the LLC are natural persons A, B and C, and A and B but not C are part of a group of related family members, does the account meet the first prong of the definition of segmented orders? What if A and B are related, and B has the same residence as C, but A and C are not related and do not have the same residence? What if A is the aunt of B and the mother of C, and A and C are cousins?

While FIF members request clarification on the above scenarios, these scenarios also illustrate the undue complexity of the proposed definition of “segmented order” in the proposed rule. This definition would be costly for firms to implement and maintain and confusing for customers to understand and would result in an inefficient use of customer time. Firms would be required to obtain certifications that customers would view as complex to comprehend, intrusive and overreaching.

FIF members request additional guidance on reporting for advisory accounts

FIF members request further guidance with respect to accounts that are managed by a registered investment advisor (“RIA”). In determining whether this type of account meets the active trading threshold, should a firm consider the trading activity of the RIA or the trading activity of the underlying account? If a firm is required to consider the activity of the RIA, should the firm consider the activity of the RIA firm or an individual employee of the RIA firm?

Firms further request that the Commission provide guidance for the scenario where an RIA creates a block order that will be allocated to multiple accounts, and the RIA does not communicate the underlying account allocations to the originating broker-dealer until after trade execution (and only if a trade execution occurs). Even assuming that the RIA could communicate the anticipated underlying accounts to the originating broker in advance of a block order, how would the originating broker classify the block account if some of the underlying accounts are above the active account threshold and others are below the active account threshold?

Dividend reinvestment and automated investment plans

If a broker aggregates dividends received by customers that participate in a dividend reinvestment plan (“DRP”), and the broker routes a buy order to the market with these funds, is this order considered a segmented order? What if some of the accounts that participate in the DRP are segmented accounts

¹⁵ Proposed Rule 600(b)(91); Proposing Release, at 391.

¹⁶ *Ibid.*

and other accounts that participate in the DRP are not segmented accounts? Similarly, if a broker aggregates funds for customers that participate in an automatic investment plan (“AIP”), and the broker routes a buy order to the market with these funds, is this order considered a segmented order? What if some of the accounts that participate in the AIP are segmented accounts and others accounts that participate in the AIP are not segmented accounts? FIF members request clarification on these scenarios.

FIF members request clarification on reporting for top-level accounts used by an investment management firm

While the Commission presumably does not intend to classify accounts for institutional investment managers as segmented accounts, as discussed above, the Commission’s proposed definition of segmented order will end up including certain institutional investment manager accounts. FIF members request confirmation that, when an investment management firm trades for institutional accounts through a top-level (or parent-level) account and allocates executions to one or more sub-accounts after trade execution, the originating broker would classify the account as a segmented account based on the ownership and trading activity of the parent account and not based on the ownership and trading activity of any sub-account. In this scenario, the originating broker-dealer typically considers the top-level account as its customer. Further, in many cases the originating broker would not know the sub-account allocations until after trade execution. FIF members request that the Commission provide clarification on this point.

FIF members request confirmation that aggregation of accounts is not required

Based on the wording of the proposed rule, FIF members understand that firms are not required to aggregate accounts when determining whether an account is a segmented account. For example, if Active AI has a trading account that executes, on average, more than 40 trades per day, and also has an IRA account that trades below this frequency threshold, FIF members understand that orders for the first account would not be segmented orders but orders for the second account would be segmented orders. Alternatively, Active AI could have two accounts that each execute, on average, 25 trades per day. FIF members understand, in this scenario, that both of these accounts would be segmented accounts. FIF members request confirmation on these points. Requiring aggregation of accounts would impose a significant additional burden on firms particularly in relation to accounts that have multiple holders. For example, if Account 1 is in the name of natural persons A, B and C, Account 2 is in the name of natural persons A and D, and Account 3 is in the name of natural persons D and E, would aggregation of all accounts be required? This type of aggregation would be burdensome for all firms and, in particular, for firms with large numbers of accounts. Aggregation could result in fewer segmented accounts but could not result in more segmented accounts.

FIF members are concerned that the following statement in the proposing release could be read to contradict the understanding in the preceding paragraph and require aggregation in the scenarios above: “... in this release, the term ‘individual investor’ will refer to natural persons that trade relatively

infrequently for their own or closely related accounts.”¹⁷ FIF members request that the Commission clarify that the phrase “closely related” is not intended to refer to multiple accounts of the same customer and is instead intended to refer to a single account in the name of multiple natural persons that are closely related.

Inter-listed securities

The Commission should provide guidance on whether an execution outside the U.S. in a security that is inter-listed in the U.S. would count towards a segmented account’s “... average daily number of trades executed in NMS stocks...”¹⁸

Time period for updating account classification

Although not expressly discussed in the proposing release, the proposed rule, as currently drafted, would require all firms to reclassify segmented accounts in their systems on an overnight basis.¹⁹ More specifically, after the close of trading on the last day of a month, every firm would need to review the trading activity of every account for the prior six calendar months and determine whether the account should be classified as a segmented account for the upcoming month. All firms would need to have all accounts reclassified prior to the open the following morning (or earlier, if there is an open competition trading center operating a pre-open qualified auction facility).

The rule, as currently proposed, also would require instantaneous reclassification of an account based on a change in beneficial ownership in the account that changes the account from a segmented account to a non-segmented account (or vice versa). For example, assume that a firm has a customer that is an LLC owned by two natural persons who are not related but have the same residence. Assume that one of the LLC owners notifies the firm of a change in residence (the residence of the other LLC owner does not change). Assume this notification is provided during the trading day. The firm would now have to instantaneously update its order handling systems during the trading day to reclassify orders for the account as non-segmented orders.

The Commission should update the proposed rule to provide firms a reasonable period of time to update their order handling systems to reflect account-level changes. For example, Cboe Exchange, Inc. (“Cboe”) and other options exchanges have adopted rules to require that accounts that exceed designated activity thresholds be classified as “professional” accounts.²⁰ Cboe members are required to update account classifications “... within five calendar days after the end of each calendar quarter.”²¹

¹⁷ Id. at 12-13.

¹⁸ Proposed Rule 600(b)(91); Proposing Release, at 391.

¹⁹ Ibid.

²⁰ See, for example, Cboe Exchange, Inc. Rule 1.1, available at https://cdn.cboe.com/resources/regulation/rule_book/C1_Exchange_Rule_Book.pdf.

²¹ Cboe Regulatory Circular RG16-064 (Mar. 30, 2016), available at <https://cdn.cboe.com/resources/regulation/circulars/regulatory/RG16-064.pdf>, at 2.

B. Originating Broker

The proposed rule defines an “originating broker” to mean “... any broker with responsibility for handling a customer account, including, but not limited to, opening and monitoring the customer account and accepting and transmitting orders for the customer account.”²² The proposed rule requires the originating broker for an order to “... establish, maintain, and enforce written policies and procedures reasonably designed to identify the orders of customers as segmented orders.”²³ The proposed rule requires the originating broker for a segmented order to be publicly identified in connection with any qualified auction unless the originating broker “... has established, maintained, and enforced written policies and procedures reasonably designed to assure that the identity of the originating broker will not be disclosed, directly or indirectly, to any person that potentially could participate in the qualified auction or otherwise trade with the segmented order...”²⁴ The proposed rule further provides that, “[W]here there are multiple originating brokers for a segmented order, an originating broker shall not be deemed to be in violation of the provisions of paragraphs (e)(1) through (3) of this section arising solely from a failure to meet a responsibility that was specifically allocated by prior written agreement to another originating broker.”²⁵

An originating broker is subject to two sets of obligations under the proposed rule:

- The obligation to identify an order as a segmented order (and implicitly, the obligation to classify every account as a segmented or non-segmented account)
- The obligation to be identified as the originating broker for a segmented order, or to take specific steps to qualify for an exception from this identification requirement.

The identification requirement (sometimes referred to in this letter as the “attribution requirement”) is a complex issue that is discussed in the sections below. In this section, we focus on the obligation of an originating broker to identify an order as a segmented order. In particular, the discussion in this section is focused on which firm should have the responsibility to identify whether an order is a segmented order (which, as discussed above, is essentially the obligation to identify whether an account is a segmented account).

Under the Commission’s proposed definition, when a firm is not self-clearing, the introducing firm and the clearing firm presumably would both be considered originating brokers, even where the clearing firm has no involvement in the handling of the order. This is because: (1) as noted above, the definition of segmented order is based on the characteristics of the account and not based on the characteristics of the order (other than the order being for an NMS security); and (2) both the introducing and clearing firms will invariably have some involvement in the opening and monitoring of the account. FIF members disagree with the approach of having two brokers that could be considered the originating broker for a

²² Proposed Rule 600(b)(69); Proposing Release, at 390.

²³ Proposed Rule 615(e)(1); Proposing Release, at 397.

²⁴ Proposed Rules 615(c)(1)(i) and 615(c)(1)(iii); Proposing Release, at 393-394.

²⁵ Proposed Rule 615(e)(4); Proposing Release, at 397.

segmented order. It is not appropriate to classify a clearing firm as an originating broker for an order when the clearing firm has no involvement in the handling of the order, and there is no regulatory justification for doing so. Even where an introducing firm routes an order to its clearing firm, it is still not appropriate to classify the clearing firm as an originating broker because the introducing firm, and not the clearing firm, receives the order from the customer. Designating multiple originating brokers for an order also creates unnecessary complexity and confusion.

FIF members believe that for any order there should be one originating broker with the responsibility to determine whether the order is a segmented order and that the firm that has this obligation should be readily determinable. More specifically, FIF members believe that the originating broker for any segmented order should be defined clearly as the broker that receives the order from the customer. For example, if an introducing firm receives an order from a customer and routes the order to its clearing firm, the introducing firm, and not the clearing firm, should be the originating broker. If an introducing firm wants to engage its clearing firm to assist the introducing firm with the introducing firm's compliance obligations under the rule, that is a matter that can be addressed directly between the introducing firm and the clearing firm.

More generally, if the Commission desires to define any firm -- other than the firm that receives an order from a customer -- as an originating broker, the Commission should provide a justification for doing so and clearly define where such other firm, and not the introducing firm, would be the originating broker. The Commission also should provide an opportunity for industry members and other market participants to comment on such proposal.

While FIF members recommend that the introducing broker should always be considered the originating broker with respect to the obligation to identify segmented accounts and orders, FIF members recommend the same approach with respect to the attribution requirement but subject to one clearly defined exception where an introducing broker routes all of its orders to its clearing firm and the clearing firm agrees in writing to take on this obligation. This is discussed in detail below.

The proposed requirements for originating brokers would impose a significant burden on a large number of broker-dealers, including many smaller broker-dealers

While FIF members believe, for the reasons discussed above, that designating the introducing broker as the originating broker is the only reasonable approach, FIF members also note that this approach would impose a significant burden on a large number of broker-dealers, including many smaller broker-dealers. The Commission estimates in the proposing release that 1,267 broker-dealers would meet the definition of originating broker "... and have responsibility for monitoring customer accounts...."²⁶ For many of these broker-dealers, implementing procedures to comply with the look-through and other requirements that would be applicable to originating brokers would be burdensome and costly. The Commission should consider and discuss the potential adverse impact that the proposed rule could have

²⁶ Id. at 155.

on smaller broker-dealers and the risk that the proposed rule could lead to a consolidation in the number of broker-dealers.

C. Customer orders routed from a non-U.S. securities dealer

FIF members request that the Commission provide guidance on how the proposed rule would apply to an order in an NMS security received by a foreign securities dealer (i.e., a securities dealer registered in a non-U.S. jurisdiction but not registered in the U.S.) from its customer and routed by the foreign securities dealer to a broker-dealer registered in the U.S. In particular, would the order routed by the foreign securities dealer to the U.S. broker-dealer be considered a “segmented order”? If so, which broker-dealer, if either, would be considered the originating broker for the order? It is likely that the U.S. broker-dealer would not have sufficient information to determine whether the customer account (which is an account of the foreign broker-dealer) would be a segmented account. At the same time, FIF members assume that the non-U.S. dealer would not be subject to the proposed rule. If these orders are not subject to the order competition rule, does this provide a competitive advance to non-U.S. dealers relative to U.S. broker-dealers? FIF members request guidance from the Commission as to whether such orders would be subject to the order competition requirement and, if so, how the provisions of the rule relating to identification and responsibilities of the originating broker would be applied.

One potential approach for this scenario would be to impose on the U.S. broker-dealer an obligation to implement policies and procedures reasonably designed to ensure that the foreign broker-dealer understands and complies with the obligation to communicate to the U.S. broker-dealer whether an order is a segmented order. In addition to the burden that this would impose on the U.S. broker-dealer, this would impose a significant burden on the foreign broker-dealer as all of the challenges discussed in the “Segmented orders” section above also would apply to the foreign broker-dealer, including all of the look-through challenges. As one example, the foreign broker-dealer would need to ascertain the family, tenancy and household employee status for the beneficial owners of an account when look-through applies. An open question discussed in the “Segmented orders” section above is whether an execution outside of the U.S. in a security that is inter-listed in the U.S. would count towards a segmented account’s “... average daily number of trades executed in NMS stocks...”²⁷ If so, this would present an additional challenge for non-U.S. dealers.

D. Inter-listed securities

Assume that an originating broker receives an order from a customer in the U.S. The account that submits the order is a segmented account. The order is for a security that is inter-listed in the U.S. and Canada. Assume that the customer directs the broker to execute the order in Canada. FIF members presume that this order would not be subject to the Order Competition Rule. FIF members request that the Commission provide clarification on this point.

²⁷ Proposed Rule 600(b)(91); Proposing Release, at 391.

Now assume that the customer does not direct where the order should be executed, and the best price is available on the Toronto Stock Exchange (“TSX”). Assume further that none of the exceptions from the order competition requirement apply. FIF members presume that the Order Competition Rule would not prohibit the originating broker from routing the order to the TSX because the originating broker is not executing the order, as defined in the proposed rule. FIF members request that the Commission provide clarification on this point.

E. Submitting a non-segmented order to a qualified auction

FIF members understand from the proposed rule that a firm is permitted (but not obligated) to submit a segmented order to a qualified auction even if an exception from the order competition requirement applies. FIF members are not clear on whether a firm is permitted to submit an order to a qualified auction if the order is not a segmented order (we refer to this type of order as a “non-segmented order”). On the one hand, the proposed rule does not prohibit a firm from submitting a non-segmented order to a qualified auction, which would indicate that a firm could submit a non-segmented order to a qualified auction. On the other hand, the proposed rule describes an auction message as “... announcing the initiation of a qualified auction for a segmented order,”²⁸ which would indicate that a firm could submit a segmented order to a qualified auction but could not submit a non-segmented order to such an auction. FIF members request that the Commission provide explicit guidance on this point, including the Commission’s rationale for proposing that a firm should be permitted (or should not be permitted) to submit a non-segmented order to a qualified auction. After understanding the Commission’s rationale on this point, market participants should have the opportunity to comment on the Commission’s proposal and rationale.

F. Submitting a market order to a qualified auction

FINRA Rule 5310, Supplementary Material .01, provides that, “[A] member must make every effort to execute a marketable customer order that it receives fully and promptly.”²⁹ If an originating broker were to receive a market order from a customer and submit the order to a qualified auction, the originating broker would have a significant risk of being in violation of FINRA Rule 5310 for two distinct reasons: first, an auction is not immediate; and second, the originating broker is required to specify a limit price when submitting a segmented order to a qualified auction,³⁰ which could result in a failed auction and a further delay in execution. FIF members request that the Commission provide guidance on how a firm could submit a segmented order to a qualified auction without the risk of violating FINRA Rule 5310.

The following scenario illustrates this point: the NBBO is \$10.00-\$10.02 at the time that an originating broker receives a buy market order from a customer; the originating broker submits the order to a qualified auction with a specified limit price of \$10.02; during the auction period, the NBBO changes to \$10.01-\$10.03; the order is not executed in the auction; the originating broker executes the order at

²⁸ Proposed Rule 615(c)(1); Proposing Release, at 393.

²⁹ Available at <https://www.finra.org/rules-guidance/rulebooks/finra-rules/5310>.

³⁰ Proposed Rule 615(a); Proposing Release, at 392.

\$10.03 against the NBO displayed on an exchange (or the originating broker executes the order at \$10.03 through a subsequent qualified auction). In this scenario, the originating broker did not execute against a posted offer at \$10.02 that was available at the time that the originating broker received the market order from the customer. In addition to being in potential violation of FINRA Rule 5310 in this scenario, the broker-dealer also could be subject to a customer lawsuit or arbitration because the broker-dealer did not handle the order in accordance with the customer's instructions. FIF members request guidance from the Commission on how a firm could avoid being subject to a violation of FINRA Rule 5310 in this scenario. FIF members further request guidance from the Commission on how a member could avoid being subject to a customer lawsuit or arbitration in this scenario. FIF members are not aware of how this could be achieved. More generally, FIF members are concerned that the challenges described in this section bring into question the feasibility of an originating broker (or a downstream broker) submitting a marketable order to a qualified auction.

G. Submitting a marketable limit order to a qualified auction

FIF members have similar concerns with regard to marketable limit orders. If an originating broker were to submit a marketable limit order to a qualified auction, the originating broker would have a significant risk of being in violation of FINRA Rule 5310, Supplementary Material .01. FIF members request guidance on how a firm could submit a marketable limit order to a qualified auction without the risk of violating FINRA Rule 5310.

Assume the same scenario as set forth in the preceding section, except that, instead of receiving a market order from a customer, the originating broker receives a marketable limit order from a customer with a limit price of \$10.03. As in the scenario above, the NBBO is \$10.00 - \$10.02 at the time of order receipt. In this scenario, the originating broker presumably would have two options for submitting the segmented order to a qualified auction: the originating broker could submit the segmented order with a specified price that is the same as the customer's limit price (\$10.03); or the originating broker could submit the segmented order with a better specified price, such as \$10.02.

Either approach would involve certain risks that bring into question the viability of qualified auctions for marketable limit orders. The first approach would involve submitting the order to a qualified auction with a specified price of \$10.03, but it is unclear from the proposed rule whether an originating broker would be permitted to submit segmented orders to a qualified auction with a specified price outside the NBBO. FIF members request clarification on this point. Even if this would be permitted, the regulators and the customer (and the customer's attorney) could question why the originating broker submitted the order to a qualified auction at \$10.03 when the originating broker could have executed the customer's order at \$10.02 against the displayed NBO.

The second approach, submitting the segmented order to a qualified auction at \$10.02, raises many of the same concerns as discussed above with respect to market orders. Assume the originating broker does not execute against a posted offer at \$10.02 that was available at the time that the originating broker received the marketable limit order from the customer. Instead, the originating broker submits the order to a qualified auction with a specified price of \$10.02, the NBBO changes to \$10.01-\$10.03

during the auction period, the order is not executed in the auction, and the originating broker executes the order at \$10.03 against the NBO displayed on an exchange (or the originating broker executes the order at \$10.03 through a subsequent qualified auction). In addition to being in potential violation of FINRA Rule 5310, Supplementary Material .01, in this scenario, the broker-dealer also could be subject to a customer lawsuit or arbitration because the broker-dealer, by changing the customer's limit and delaying execution of the order, did not handle the order in accordance with the customer's instructions. FIF members request guidance from the Commission on how a firm could avoid being subject to a violation of FINRA Rule 5310 in this scenario. FIF members further request guidance from the Commission on how a member could avoid being subject to a customer lawsuit or arbitration in this scenario. FIF members are not aware of how this could be achieved.

H. Held orders

The Commission has distinguished between held and not held orders as follows: “[T]ypically, a ‘not held’ order provides the broker-dealer with price and time discretion in handling the order, whereas a broker-dealer must attempt to execute a ‘held’ order immediately.³¹ Segmented orders typically will be held orders. It is unclear how a firm could submit a marketable held order to a qualified auction and also comply with its obligation to execute this held order immediately.

In addition, as noted by the Commission, an originating broker does not have price or time discretion for a held order. Given that an originating broker does not have price discretion for a held order, how could an originating broker specify a price when submitting a held market order to a qualified auction? It also is unclear how an originating broker, when submitting a held marketable limit order to a qualified auction, could specify a price that is different than the limit price provided by the customer. This raises another question. If the specified price for a qualified auction must be the same as the customer's limit price, and the customer's limit price for a held marketable limit order is outside the NBBO, could the originating broker submit this order to a qualified auction with a specified price that is the same as the customer's limit price, even though the specified price is outside the NBBO?

I. Executing a segmented order against an order displayed on a continuous order book

As the discussion in the preceding sections demonstrates, for marketable orders, which according to Commission data would represent the vast majority of segmented orders that are currently sent to market makers, it appears that the only viable alternative for a firm could be to execute the order against a displayed order on a continuous order book. Apart from the fact that this provides no price improvement for the customer order, FIF members are concerned about the following discussion in the proposing release:

Importantly, however, all relevant broker-dealer best execution responsibilities would govern the extent to which segmented orders could be routed to an open competition trading center or national securities exchange without first clearing a qualified auction.

³¹ Securities Exchange Act Release No. 84528 (Nov. 12, 2018), 83 FR 58338 (Nov. 19, 2018) (Disclosure of Order Routing Information), at 10.

As discussed in section III.B.2 above, best execution generally requires a broker-dealer to obtain the best terms reasonably available for customer orders. Because liquidity providers can profitably offer better prices to segmented orders of individual investors with low adverse selection costs as compared to the prices they can offer other types of order flow, trading mechanisms that offer such segmentation, as would a qualified auction, are quite likely to obtain better prices for segmented orders than other trading mechanisms, such as the continuous order book of an open competition trading center or national securities exchange, that commingle all types of order flow. A broker-dealer would need to consider the opportunity for better prices in its best execution analysis.³²

The Commission discusses a fast moving market as one scenario where a firm would be justified in executing a segmented order against an order displayed on a continuous order book and does not identify any other scenarios where this could be justified.³³ The Commission is stating in this passage that what is potentially the only viable option available to a firm for executing a marketable order – executing the segmented order against a displayed order on a continuous order book – would raise best execution concerns. Given this guidance by the Commission in the proposing release, it appears that under the proposed rule any action that a firm could take for a segmented order (other than providing a mid-point execution) would put the firm in violation of a Commission or FINRA order handling requirement or regulatory guidance from the Commission. It is also unclear whether there is any scenario other than a fast moving market where a firm would be permitted to execute a segmented order against an order displayed on a continuous order book. FIF members request clarification on these points.

J. Potential conflicts with other FINRA rules

Manning Rule

FINRA Rule 5320(a) (often referred to as the “Manning rule”) provides,

(a) Except as provided herein, a member that accepts and holds an order in an equity security from its own customer or a customer of another broker-dealer without immediately executing the order is prohibited from trading that security on the same side of the market for its own account at a price that would satisfy the customer order, unless it immediately thereafter executes the customer order up to the size and at the same or better price at which it traded for its own account.³⁴

It is unclear how a firm could comply with its Manning obligations if it submits a segmented order to a qualified auction. Assume the following scenario: the NBBO is \$9.95-\$10.00; a market maker receives a marketable limit order to buy with a limit price of \$10.00; the order is marked as a segmented order; the market maker submits the order to a qualified auction operated by an exchange; the auction is pending.

³² Proposing Release, at 76.

³³ Id. at 76-77.

³⁴ Available at <https://www.finra.org/rules-guidance/rulebooks/finra-rules/5320>.

Meanwhile, the market maker has an open order to buy at \$9.98 resting, non-displayed, on another exchange. The non-displayed order is executed on this other exchange at \$9.98. Because the customer order has not yet been executed, the execution of the non-displayed order triggers a Manning obligation; the market maker owes the customer a fill at \$9.98 or better. Because the auction is still in process, the market maker is unable to fill the customer order. The auction now concludes, with the customer order receiving an execution from the auction at \$9.99. It is unclear what actions the market maker could take at this point that would satisfy its regulatory obligations. It does not appear from the proposed rule that the market maker could take the auction execution into inventory (and then sell to the customer at \$9.98) because this would appear to conflict with the requirement that only segmented orders can be submitted to a qualified auction. FIF members request that the Commission provide guidance on how a firm could comply with its Manning obligations when it submits a segmented order to a qualified auction. FIF members are not aware of how this could be achieved.

FINRA crossing requirement

FINRA Rule 5320, Supplementary Material .07, provides:

“... 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. In the event that a member is holding multiple orders on both sides of the market that have not been executed, the member must make every effort to cross or otherwise execute such orders in a manner that is reasonable and consistent with the objectives of this Rule and with the terms of the orders. A member can satisfy the crossing requirement by contemporaneously buying from the seller and selling to the buyer at the same price.”³⁵

The proposed rule would permit a broker-dealer to cross a segmented marketable order against a contra-side order at the mid-point of the NBBO or better (from the perspective of the segmented order). If the segmented marketable order can be crossed but not at the mid-point or better, the proposed rule would not permit the broker-dealer to cross the segmented marketable order against a contra-side order. This would appear to conflict with FINRA Rule 5320, Supplementary Material .07. Consider the following scenario: the NBBO is \$10.00-\$10.04; an originating broker receives a market order to buy; the originating broker submits this order to a qualified auction; the originating broker then receives a limit order to sell at \$10.03. In this scenario, how can the originating broker comply with its obligations under FINRA Rule 5320, Supplementary Material .07, without violating the proposed Order Competition rule? FIF members request that the Commission provide guidance on this issue.

³⁵ Ibid.

Even if the contra-order in this scenario had a limit price of \$10.02 (which is the mid-point), it is unclear how the broker-dealer could comply with the FINRA crossing requirement if the broker-dealer has already submitted the segmented marketable order to a qualified auction. Would the broker-dealer be permitted to cancel the segmented marketable order from the qualified auction?

K. Exception for auctions not in effect

The proposed rule provides five exceptions to the order competition requirement. The first exception applies where "... [T]he segmented order is received and executed by the restricted competition trading center during a time period when no open competition trading center is operating a qualified auction for the segmented order..."³⁶ FIF members request that the Commission provide additional guidance as to what is meant by an OCTC "... operating a qualified auction for the segmented order..." In particular, if an RCTC is in receipt of a segmented order, it is not possible at that time that a qualified auction would be operating for that segmented order. A qualified auction for the segmented order could not commence until the RCTC has submitted the segmented order to a qualified auction. This means that the first exception would apply in all cases. FIF members do not believe that this is the Commission's intent. Presumably, what the Commission intends is that an exception would apply where there is no OCTC at the time of order receipt by the RCTC that is operating a qualified auction facility for the applicable NMS stock. To clarify this point, the Commission should distinguish in the proposed rule between a qualified auction, which would represent a single instance of a qualified auction, and a qualified auction facility, which would represent a facility that operates qualified auctions on an ongoing basis. Applying this terminology, at the time of receipt by an RCTC of a segmented order, there will not be a qualified auction in operation for that segmented order, but there could be an OCTC that is operating a qualified auction facility for the applicable NMS stock. The Commission should revise the proposed rule to clarify this distinction.

FIF members note further that the order competition requirement should only apply where there is at least one OCTC at the time of order receipt by the RCTC that -- to the knowledge of the RCTC based on the information available to the RCTC at that time -- would initiate a qualified auction upon receipt of the segmented order from the RCTC. As an example, if there is one qualified auction facility in operation for an NMS stock, that facility does not operate multiple qualified auctions simultaneously, and the OCTC that operates the facility has communicated to market participants that the OCTC is currently operating a qualified auction for the NMS stock, a firm receiving a segmented order for that NMS stock should not be subject to the order competition requirement. The Commission should incorporate this point into any reissuance of the proposed rule.³⁷

Assuming that the order competition requirement would apply only where, at the time of receipt of a segmented order by an RCTC, there is an OCTC that (to the RCTC's knowledge) would initiate a qualified auction upon receipt of the segmented order from the RCTC, the Commission should provide further

³⁶ Proposed Rule 615(b)(1); Proposing Release, at 392.

³⁷ As discussed below, FIF members recommend that there be a minimum of two qualified auction facilities in operation for a stock at any time. But at a minimum, there must be at least one qualified auction facility, not just in operation, but also that will accept the segmented order from the RCTC.

clarity as to how an RCTC would determine, at the time of receipt of a segmented order, whether there is an OCTC that would initiate a qualified auction for the segmented order. Clarity is required with respect to the following workflows:

- The proposing release provides that “[P]roposed Rule 615 allows flexibility for open competition trading centers in a variety of other contexts. For example, it does not specify whether an open competition trading center may or may not simultaneously operate multiple qualified auctions for the same NMS stock...”³⁸ If an OCTC were to elect not to simultaneously operate multiple qualified auctions for the same NMS stock, this means that the OCTC would reject a segmented order from an RCTC if the OCTC were conducting a qualified auction in the applicable stock at the time of receipt of the segmented order. How would the policies of each OCTC relating to the operation of simultaneous auctions (i.e., whether the OCTC permits simultaneous auctions) be communicated to all RCTCs systematically? Further, if an OCTC has a policy of not permitting simultaneous auctions in the same stock, how would the fact that an OCTC is conducting a qualified auction in the applicable stock be communicated to all RCTCs systematically?³⁹
- Presumably, each OCTC would need to disclose the time periods during which it operates any qualified auction facility. How would this be communicated to all RCTCs systematically?
- More generally, each OCTC presumably would need to disclose to all RCTCs the terms of operation of each qualified auction facility that it operates (for example, the auction time period). How would these terms of operation be communicated to all RCTCs systematically?
- The proposed rule does not specify how RCTCs are expected to respond when a qualified auction facility is unavailable for technical reasons and any documentation that RCTCs are required to prepare in connection with such an event. Documenting these types of events would be burdensome for firms. FIF members recommend that the Commission take on the responsibility to monitor and document the status of the various qualified auction facilities (based on reports from the respective OCTC operators) and communicate status issues to market participants, so it is not necessary for every RCTC to take on this responsibility.

FIF members also request clarification on the following discussion in the proposing release:

The Commission is cognizant of concerns regarding the possibility of a decline in execution quality due to the implementation of qualified auctions. This includes the possibility that a qualified auction host could decide not to host an auction for a particular stock. However, if an order fails to execute in one auction, it could be directed quickly to other auctions, and/or the wholesaler would have the option to internalize the order at the same or better price at which it was exposed in the first auction.⁴⁰

³⁸ Proposing Release, at 122.

³⁹ Please see below for a further discussion of the view of FIF members that an OCTC, if it operates qualified auctions for an NMS stock, should be required to operate simultaneous qualified auctions for the stock.

⁴⁰ Proposing Release, at 277-278.

If a qualified auction host decides not to host an auction, how could an order fail to execute in that auction? Is the Commission saying that an OCTC could inform an auction submitter that the OCTC will not host an auction without having provided prior notice of that fact to all RCTCs? This would be a significant concern for FIF members. The Commission should clarify this point.

L. Exception for orders that are at least \$200,000

The proposed rule provides an exception from the order competition requirement where “... [T]he market value of the segmented order is at least \$200,000 calculated with reference to the midpoint of the national best bid and national best offer when the segmented order is received by the restricted competition trading center.”⁴¹ The Commission writes that “[T]his exception is designed to address the heightened liquidity need of large orders that often may be more appropriately addressed outside of a qualified auction.”⁴² The liquidity challenges for an order are not simply dependent on the size of the order but are instead dependent on the size of the order relative to the available liquidity in the stock. Accordingly, the Commission should consider proposing exceptions from the order competition requirement for the following categories of orders:

- Orders that are above a specified percentage of ADV (average daily trading volume)
- Not held orders (including VWAP orders)
- Orders where the share quantity is greater than the sum of the share quantity displayed at the opposite-side NBBO and other exchange BBO quantity displayed at that price in Level 1 data
- Directed orders.

FIF members note that there are many retail orders that are not held orders and that outsize the NBBO. In addition, as discussed above, because of the “look-through” requirement under the proposed rule, the proposed definition of segmented order would encompass many institutional orders. In any reissuance of the rule proposal, the Commission should provide its rationale for why it would or would not propose the exceptions above. The Commission also should discuss whether or not it would be appropriate to provide customers with an opt-out from the order competition requirement and, if so, whether the opt-out should be available only under certain circumstances.

M. Approval and implementation process for a qualified auction facility

FIF members request that the Commission provide additional guidance as to the approval and implementation processes for an auction facility, as this process is not discussed in the proposing release. For example, would an exchange OCTC be required to submit a Form 19b-4 filing⁴³ with the Commission for a rule change to establish a new auction facility? Would a Form 19b-4 filing similarly be required for an exchange OCTC to change any terms relating to the operation of an auction facility? Upon the Commission’s approval of an auction facility or an amendment to an auction facility, what is

⁴¹ Proposed Rule 615(b)(2); Proposing Release, at 393.

⁴² Id. at 102.

⁴³ 17 CFR §240.19b-4.

the implementation time period that would be provided to industry members to update their systems to comply with the business rules and technical requirements of the new or updated auction facility? Are there specific types of changes to a qualified auction facility that could take effect upon filing with the Commission as provided in Section 19(b)(3) of the Securities Exchange Act and Rule 19b-4(f) thereunder?⁴⁴ If so, how would the Commission determine which types of changes could take effect upon filing?

An ATS also could be an OCTC. What is the approval process for an ATS OCTC to establish a new auction facility? What is the approval process for an ATS OCTC to modify an existing auction facility? What is the implementation time period that would be provided to industry members to update their systems to comply with the business rules and technical requirements of a new or updated auction facility operated by an ATS OCTC?

Could an exchange or ATS that has not yet reached the 1% volume threshold to qualify as an OCTC⁴⁵ obtain approval for a qualified auction facility subject to its achieving this 1% threshold? After having obtained Commission approval, could the exchange or ATS then go-live with the auction facility immediately upon achieving the 1% threshold? This could conflict with the obligations of an ATS to provide thirty days' prior notice of a material change.⁴⁶ Alternatively, is an exchange or ATS required to demonstrate that it qualifies as an OCTC as a condition to obtaining Commission approval of a qualified auction facility? Does the Commission separately approve an exchange or ATS as an OCTC, or does the Commission only approve a specific auction facility established by an OCTC, with the exchange or ATS having to demonstrate to the Commission, at the time of the request for approval by the exchange or ATS, that the exchange or ATS qualifies as an OCTC? If an exchange or OCTC that has obtained Commission approval to operate an auction facility subsequently falls below the 1% volume threshold to qualify as an OCTC, presumably the OCTC would be required to cease its operation of any qualified auctions. Would specific advance notice to the regulators or industry be required? This could be problematic for industry members because whether an OCTC continues to qualify as an OCTC for the first trading day of a calendar month might not be known until after all trading has concluded for the prior calendar month (which would be the evening of the prior trading day). Requiring an ATS to cease operation of a qualified auction facility in this scenario could conflict with the regulatory requirement for an ATS to provide thirty days' prior notice of a material change.

In general, it is critical that industry members have sufficient advance notice of any events, such as the introduction of a new qualified auction facility or changes to a previously-approved qualified auction facility, that would require industry members to update their systems. Prior notice periods should be incorporated in any reissuance of the proposed rule.

⁴⁴ 15 U.S.C. §77s(b)(3). 17 CFR §240.19b-4(f).

⁴⁵ Proposed Rules 600(b)(64)(i)(C) and 600(b)(64)(ii)(F); Proposing Release, at 390.

⁴⁶ 17 CFR §242.304(a)(2).

N. Conditions for introducing qualified auction facilities into production

The proposed rule and the proposing release do not appear to provide for any implementation period or any conditions for introducing qualified auction facilities. Specific conditions should be satisfied before qualified auction facilities are introduced into production. These conditions should be expressly incorporated into the Order Competition Rule.

There are at least two types of events that must be considered relating to the introduction of qualified auction facilities:

- The initial launch of the first group of qualified auction facilities into production
- Subsequent to the initial launch of the first group of qualified auction facilities, an OCTC commencing operation of a new qualified auction facility (which could be the first qualified auction facility operated by the OCTC or an additional qualified auction facility to be operated by the OCTC).

Before the introduction of the first qualified auction facility into production, the Commission should ensure that this facility would have the ability to simultaneously operate a sufficient number of qualified auctions to efficiently process all segmented orders that could be submitted to the facility. This condition should be incorporated into the proposed rule. FIF members also would be concerned with an initial launch that only involves one qualified auction facility for an NMS stock and recommend that a qualified auction facility should not be permitted to launch for any NMS stock until there are at least two qualified auction facilities for that NMS stock.

In addition to the condition above for the introduction of the first qualified auction facility into production, the Commission should incorporate into the proposed rule the required conditions for the introduction of any new qualified auction facility into production. These conditions should include the following:

- The filing of proposed rule changes by the applicable OCTC with the Commission
- The opportunity for market participants to comment on the OCTC's rule filing
- The Commission's approval of the OCTC's rule filing
- Upon approval, publication by the OCTC of technical specifications and other technical documentation
- A reasonable period for market participants (including the OCTC and the SIPs) to update their systems to conform to the updated technical specifications
- A reasonable period for market participants to test the qualified auction functionality in a test environment provided by the OCTC.

Similar conditions should apply for any material change to a qualified auction facility, which should include any change that would require industry members to update their systems. Given the need for additional clarity as to how qualified auctions would operate (as discussed in this comment letter), FIF members are not in a position at this time to provide a recommendation as to what would represent a

reasonable advance notice period for the introduction of a new qualified auction facility or a change to an existing qualified auction facility. In any reissuance of this proposed rule, the Commission should provide market participants and other commenting parties the opportunity to comment on what would be a reasonable implementation period for the initial launch of the first qualified auction facility (or group of qualified auction facilities) into production, the introduction of a subsequent qualified auction facility into production, and specific categories of changes to an existing qualified auction facility. These minimum implementation periods for specific events (the launch of a new facility or a change to an existing facility) should be incorporated into the proposed rule. The appropriate implementation period of an event would be dependent on the technical work required for industry members, the required level of testing, and the potential risks to market resiliency.

O. Operating simultaneous auctions

The Commission notes in the proposing release that proposed Rule 615 "... does not specify whether an open competition trading center may or may not simultaneously operate multiple qualified auctions for the same NMS stock, and if so, the execution priority required for auction responses across such auctions."⁴⁷ The proposing release does not discuss why an OCTC should be permitted to refrain from simultaneously operating multiple qualified auctions for the same NMS stock. Permitting an OCTC to refrain from simultaneously operating multiple qualified auctions for the same NMS stock would appear to run contrary to the intent of the proposed rule. Further, it is not clear why an OCTC would want to prevent simultaneous auctions in the same NMS stock.

FIF members believe that it should be a requirement for any OCTC to run multiple, simultaneous auctions for one stock; or for the OCTC to seek Commission approval for an alternative mechanism that likewise would provide the ability for "many" segmented orders to be auctioned and traded immediately. If industry members are required to code their order handling logic to account for qualified auction facilities, industry members need to know that these facilities will be available for any orders that they submit to a qualified auction facility. If the Commission considers it important to allow an OCTC to refrain from operating simultaneous auctions in the same stock, the Commission should provide its rationale for this approach and allow market participants the opportunity to comment on this rationale. It is unclear to industry members as to how this type of limitation could be justified given the objectives of the proposed rule.

P. Qualified auction system capacity

The proposed rule would permit a qualified auction facility to refrain from operating simultaneous auctions in the same stock. Does this mean that the proposed rule would allow an OCTC to reject the submission of a segmented order based on capacity limitations? FIF members believe that a qualified auction facility should only be approved by the Commission if the Commission can determine that the auction facility has the ability to simultaneously operate a sufficient number of qualified auctions to efficiently process all segmented orders that could be submitted to its qualified auction facility. When

⁴⁷ Proposing Release, at 122.

determining the capacity that a qualified auction facility should be required to handle, the Commission should take into account the contingency that one or more other qualified auction facilities could become unavailable due to a technical issue. This approach is necessary to address the risk of a domino effect where the failure of one qualified auction facility increases the load on other qualified auction facilities and thereby causes the failure of the other qualified auction facilities.

More generally, the Commission should provide estimates for the number of simultaneous auctions in a symbol it expects could occur and discuss any potential impact on market resiliency.

Q. Minimum execution size for segmented order submitted to a qualified auction facility

Would a firm submitting a segmented order to a qualified auction facility be permitted to specify a minimum execution size (such as a round lot) for the auction? If so, would the proposed rule require that this minimum size be communicated to market participants? FIF members request clarification on these questions.

R. Unsuccessful auctions

For this letter, we define an “unsuccessful auction” to mean an auction where the submitter did not cancel the segmented order during the auction period and did not receive a full execution of the segmented order. Proposed Rule 615(a) provides that,

[A] restricted competition trading center shall not execute internally a segmented order for an NMS stock until after a broker or dealer has exposed such order to competition at a specified limit price in a qualified auction that meets the requirements of paragraph (c) of this section and is operated by an open competition trading center.⁴⁸

The proposing release provides the following further guidance:

If the segmented order did not receive a full execution in the qualified auction, the unexecuted order, or unexecuted portion thereof, would be canceled back to the wholesaler, who could, as soon as reasonably possible, execute the segmented order, or unexecuted portion thereof, internally at a price that was equal to or better for the segmented order than the specified limit price.⁴⁹

...

... a retail broker that currently routes segmented orders directly to a wholesaler could instead route such orders directly to a qualified auction with a specified limit price selected by the retail broker. Such specified limit price would need to be consistent with

⁴⁸ Proposed Rule 615(a); Proposing Release at 392.

⁴⁹ Id. at 72.

its best execution responsibilities and the terms of the order as set by the customer. If the segmented order did not receive an execution in the auction at the specified limit price, the retail broker could, as soon as reasonably possible, route the segmented order to a wholesaler with a representation that the segmented order had cleared (i.e., not received an execution in) a qualified auction at that price. The wholesaler then could, in compliance with Proposed Rule 615, as soon as reasonably possible, execute the segmented order internally at the specified limit price or better.⁵⁰

There are other scenarios involving unsuccessful auctions that should be considered:

- Consider the scenario where an originating broker routes a segmented order to a market maker, the market maker submits the order to a qualified auction, the auction is unsuccessful, and the market maker returns the order to the originating broker. If the originating broker routes this order to a second market maker with a limit price that is at or better than the specified price for the previously unsuccessful auction, is the second market maker permitted to execute this order without submitting this order to a qualified auction?
- Also consider the scenario where an originating broker submits a marketable order to a qualified auction, the qualified auction is unsuccessful, the order is no longer marketable as of the end of the qualified auction period, and the originating broker posts the order on an exchange or ATS. Would the exchange or ATS be permitted to execute this order based on proposed Rule 615(g)(4) and 615(b)(4), respectively?⁵¹

FIF members request that the Commission provide additional clarification on these scenarios.

FIF members note two practical requirements in the scenarios above that should be coordinated. First, if an originating broker routes a segmented order directly to a qualified auction that is unsuccessful, and then reroutes the segmented order to a market maker for execution, the originating broker would need to include with any subsequent route a flag to signal a prior unsuccessful qualified action so that the market maker could immediately execute the order. Second, if a market maker receives a segmented order and sends it to a qualified auction that is unsuccessful, and then cancels that order back to the originating broker, the market maker would need to communicate this same flag to the originating broker on the cancel confirmation message.

S. Child routes

An additional complication arises if an originating broker routes a portion of a segmented order to a market maker. Assume that the market maker submits this portion of the segmented order to a qualified auction, and the auction is a failed auction. Presumably, the order competition requirement would continue to apply to the portion of the segmented order that was not routed to the market maker (though this is not specified in the proposed rule). Would the portion of the order that was

⁵⁰ Id. at 74.

⁵¹ Proposed Rule 615(b)(3) and 615(g)(3); Proposing Release, at 393 and 398.

submitted by the market maker to the qualified auction be excepted from the order competition requirement, or would the exception only apply if the full segmented order were submitted to the qualified auction? How would the order competition requirement apply in the scenario where two portions of a segmented order are submitted to different qualified auctions with different specific prices and both auctions are unsuccessful? The term “segmented order” is defined in the proposed rule at the parent order level, so it is not clear how the rule would apply where a portion of a segmented order is routed as a child order. FIF members request that the Commission provide additional clarification on how the rule would apply to partial child routes and that the wording of the rule be modified in any reissuance of this rule proposal to reflect this scenario.

T. Auction responses when an OCTC can operate multiple simultaneous auctions

Every auction will need to have an auction identifier so that a responder can designate the specific auction that it is responding to. The Commission should clarify whether an OCTC operating multiple simultaneous qualified auctions in a stock could permit a responder to submit the same response to multiple qualified auctions with the OCTC taking on the responsibility to ensure that the responder’s order is not over-executed. If this type of response would be permitted, the Commission should clarify whether an OCTC could permit a responder to respond with a larger size than the size communicated by the OCTC in the auction message. The Commission also should clarify whether an OCTC could permit a responder to submit a response that would enable the responder to participate not only in current qualified auctions, but also in future qualified auctions. The Commission also should clarify whether an OCTC could provide this functionality as an “auction only” order type where the order functions as an auction response for any qualified auction (assuming the specified limit price for the qualified auction is within the limit price of the party submitting the auction only order type), but the order does not rest on the exchange’s continuous order book. The Commission should clarify whether, alternatively, the OCTC could provide an order type where the order rests on the exchange’s continuous order book and also can participate in any qualified auctions (potentially at a more aggressive price in the qualified auctions). FIF members request that the Commission provide additional guidance as to whether an OCTC would be permitted to offer any of the above functionality and the rationale for permitting or not permitting such functionality. Market participants would need to understand these potential workflows to comment meaningfully on the proposed rule.

For liquid stocks, there could be many simultaneous qualified auctions operating at a specific point in time. There is also uncertainty as to the ability of a responder to obtain an execution in any qualified auction given that there could be many firms responding to the same auction message. Given these factors, it is important for market participants to understand the mechanisms that would be available to market participants to interact effectively with multiple auctions.

FIF members also request guidance on whether an OCTC would be permitted to allow an auction responder to specify a minimum execution size (such as a round lot) in its auction response.

U. Ability for segmented orders to cross

As discussed above, for liquid stocks, there could be many simultaneous qualified auctions operating at a specific point in time. Some of these auctions could be initiated with buy segmented orders and some could be initiated with sell segmented orders, yet it appears that there would be no opportunity for the segmented orders submitted to these qualified auctions to interact with each other. For example, if there are two qualified auctions for the same stock and one qualified auction ends a microsecond before the other qualified auction ends, at the time that the first auction ends, the second segmented order is still involved in a qualified auction. By the time the second auction ends, the first segmented order is no longer available.

Under the proposed rule, would an OCTC be permitted to establish procedures whereby opposite-side segmented orders could interact with each other? The Commission should clarify whether this type of functionality would be permitted and, if so, under what conditions. Market participants should have the opportunity to comment after this is clarified.

V. Pegged auction responses

Given the potential duration of a qualified auction, an auction responder might want to respond to a qualified auction with a pegged price instead of a fixed price. The Commission should clarify whether it would allow an OCTC to permit an auction responder to submit a pegged auction response as opposed to an auction response with a fixed price.

W. Auction period

Under the proposed rule, an OCTC is required to “... accept auction responses for a period of at least 100 milliseconds after an auction message is provided ...” and “... end the auction not more than 300 milliseconds after an auction is provided for dissemination in consolidated market data.”⁵² Is an OCTC required to set the duration for all qualified auctions (for a specified qualified auction facility) to a pre-determined fixed amount between 100 and 300 milliseconds? Is an OCTC permitted to vary the duration of an auction based on the NMS stock, time of day or some other characteristic of the auction? Is an OCTC required to provide transparency as to the specific conditions for each auction duration that could apply? Can an OCTC determine the duration for an auction immediately prior to its dissemination of an auction message and announce this duration in the auction message? Can an OCTC apply a random function in determining the duration of an auction? Can an OCTC operate a qualified auction without disclosing in advance to market participants the duration of the auction? What level of detail relating to auction duration is an OCTC required to disclose in its regulatory filings and as part of the regulatory approval process? If an OCTC is not required to disclose the auction duration prior to an auction, a responder would need to respond sooner to avoid missing the cut-off, but its response could become stale if the market moves. Responders would need to consider this increased adverse selection when

⁵² Proposed Rule 615(c)(2); Proposing Release, at 394.

pricing their responses. FIF members request that the Commission provide additional clarification on these questions.

The Commission explains in the proposing release that the intent of the 100 millisecond minimum period "... is to help ensure that a wide variety of market participants will have the technological capacity to submit responses to fast automated auctions."⁵³ FIF members recommend that the Commission, in any reissuance of the proposed rule, present the option of providing flexibility for this minimum time period to accommodate future market and technical developments. More generally, could the rule be written to permit an OCTC to optimize the conduct of its auction mechanism, based on real-world, scientific observations of its effectiveness, even if those observations contradict the initial requirements of the proposed rule? FIF members note that such findings are likely to happen much more quickly than any future rulemaking process would require to make amendments.

X. Order cancels

FIF members request clarification on whether a firm that submits a segmented order to a qualified auction is permitted to cancel the order during the auction period. Presumably, if a customer cancels a segmented order (the parent level order), the firm that submitted the order to a qualified auction should have the right to cancel its submission to the auction if the auction period has not yet expired. FIF members request clarification on this point. FIF members also request clarification on whether a firm that responds to a qualified auction would be permitted to cancel that response during the auction period.

Y. Minimum price increments

Proposed Rule 615(c)(3) provides:

Segmented orders and auction responses shall be priced in an increment of no less than \$0.001 for segmented orders and auction responses with prices of \$1.00 or more per share, in an increment of no less than \$0.0001 for segmented orders and auction responses with prices of less than \$1.00 per share, or at the midpoint of the national best bid and national best offer.⁵⁴

Current Commission Rule 612(a) provides:

No national securities exchange, national securities association, alternative trading system, vendor, or broker or dealer shall display, rank, or accept from any person a bid or offer, an order, or an indication of interest in any NMS stock priced in an increment smaller than \$0.01 if that bid or offer, order, or indication of interest is priced equal to or greater than \$1.00 per share.⁵⁵

⁵³ Id. at 111.

⁵⁴ Proposed Rule 615(c)(3); Proposing Release, at 394.

⁵⁵ 17 CFR §242.612(a).

FIF members request guidance on how the conflict between these two provisions will be addressed.

Z. Auction execution priority

Can an OCTC favor any parties in a qualified auction?

Proposed Rule 605(c)(5)(iv) provides that “[T]he terms of execution priority shall not favor the broker or dealer that routed the segmented order to the auction, the originating broker for the segmented order, the open competition trading center operating the auction, or any affiliate of the foregoing persons.”⁵⁶ The Commission should clarify whether this means that an OCTC can favor parties in a qualified auction that do not fall within these specified categories. If this type of favoritism is permitted, the Commission should clarify which types of favoritism the Commission would permit or not permit, and what would be the justification for permitting these types of favoritism. It is important for firms to understand these types of details to meaningfully comment on the proposed rule.

Assuming that an OCTC could prioritize some parties, but not the originating broker or the party that submitted the segmented order to the qualified auction, or any of their affiliates, how would the OCTC know which parties are affiliated with which other parties? It should be noted that, in some cases, certain parties involved in the receipt and routing of the segmented order will not be members of the applicable OCTC.

Responses with the same level of priority

Under the proposed rule, auction responses representing customer orders at the same price have the same priority.⁵⁷ If there are no displayed orders at the same or a better price (from the perspective of the auction submitter) and the aggregate shares of the auction responses at the best auction response price exceed the shares routed to the qualified auction, what are the permitted and prohibited methods for the OCTC to allocate the execution among the auction responders?

Expected complexity of auction priority rules

The following factors, taken together, will mean significant complexity in auction priority rules:

- There could be many simultaneous auctions in operation for the same stock
- There could be many responders for the same qualified auction, such that the aggregate share quantity of the responses for a specific qualified auction greatly exceeds the quantity of the segmented order
- Time priority is not permitted under the proposed rule.

⁵⁶ Proposed Rule 615(c)(5)(iv); Proposing Release, at 395.

⁵⁷ Proposed Rule 615(c)(5); Proposing Release, at 395-396.

Given the factors above, could an OCTC prioritize responders based on the volume of auction responses submitted by a responder for the applicable stock over a specified period? Could an OCTC prioritize responders based on whether the responders did not receive allocations for prior qualified auctions for the same stock?

Priority of customer over broker-dealer orders

Under the proposed rule, auction responses for the account of a customer have priority over auction responses for the account of a broker or dealer at the same price.⁵⁸ How would the fact that an order is a customer or broker-dealer order be communicated to an OCTC? Is this a new data element that all broker-dealers would need to include in any order route? FIF members also request guidance as to how the following orders would be classified for this purpose:

- ***Riskless principal orders.*** FIF members presume that where a broker-dealer is trading as riskless principal this would be considered an order for the account of a broker or dealer. FIF members request clarification on this point.
- ***AIPs and DRPs.*** Would orders aggregated by a broker-dealer in connection with an AIP or DRP plan be considered customer or broker-dealer orders?

AA. Attribution of originating broker

Two options available to an originating broker

The proposed rule requires the originating broker for a segmented order to be publicly identified in connection with any qualified auction unless the originating broker "... has established, maintained, and enforced written policies and procedures reasonably designed to assure that the identity of the originating broker will not be disclosed, directly or indirectly, to any person that potentially could participate in the qualified auction or otherwise trade with the segmented order...."⁵⁹ Based on this provision, an originating broker has two options with respect to a segmented order:

- Permit itself to be publicly attributed in any auction message
- Establish policies and procedures to prevent any person with knowledge of the originating broker's identity to be disclosed, directly or indirectly, to any person that potentially could participate in the qualified auction or otherwise trade with the segmented order.

For the reasons discussed below, FIF members do not consider that compliance with the 2nd option would be feasible based on how the proposed rule is currently drafted. This means that all originating brokers would need to be publicly attributed in connection with any qualified auction.

⁵⁸ Proposed Rule 615(c)(5)(ii); Proposing Release, at 395.

⁵⁹ Proposed Rules 615(c)(1)(i) and 615(c)(1)(iii); Proposing Release, at 393-394.

Public attribution

In the proposing release, the Commission provides the following rationale for the public attribution requirement:

“Data analysis indicates that adverse selection costs can vary substantially among different retail brokers. Knowing the identity of the originating broker would therefore be a significant piece of information in pricing an auction response. Accordingly, if only some market participants knew the identity of the originating broker, other potential responders may not participate due to fear of the winner’s curse (winning the least advantageous auctions and losing the most advantageous auctions because of an information disadvantage). Limited participation could harm the competitiveness of qualified auctions.”⁶⁰

Attribution of the originating broker could be adverse to the underlying customer, particularly for orders in less liquid stocks and orders that are closer in size to the \$200,000 threshold set forth as an exception in the proposed rule. We do not discuss this point further in this letter as we consider this a policy question, except to say that industry members have concerns about this required disclosure and will identify these concerns through comment letters from other industry associations and individual firm comment letters.

Compliance with the non-attribution requirements is not feasible based on how the proposed rule is currently drafted

Under the proposed rule, attribution of the originating broker presumably would be required in all cases because it does not appear that compliance with the non-attribution requirements, as set forth in the proposed rule as currently drafted, would be feasible. The scenarios set forth below in this section demonstrate this point. For these scenarios, assume that: (i) all orders are for the same NMS stock; (ii) all orders are segmented orders; (iii) the exchange is an OCTC; and (iv) the ATS is an RCTC.

Scenario 1: opposite-side customer order posted on exchange. The NBBO is \$10.00-\$10.05. Customer 1 (C1) transmits to Originating Broker 1 (OB1) a limit order to sell at \$10.05. OB1 posts a limit order to sell at Exchange 1 (E1). Customer 2 (C2) transmits to OB1 a market order to buy. OB1 routes the buy order to a qualified auction operated by E1 with a specified limit price of \$10.05. OB1 has elected not to be attributed on the order from C2.

These two orders could interact in the qualified auction, which would presumably cause OB1 to be in violation of the Order Competition Rule. This is because, under the proposed rule, if OB1 elects to remain unattributed for a segmented order, OB1 (including on behalf of a customer order) is not permitted to participate as a counter-party in the applicable qualified auction.⁶¹

⁶⁰ Id. at 109.

⁶¹ Proposed Rule 615(e)(3); Proposing Release, at 397.

One alternative for OB1 -- canceling C1's sell order from E1 -- would raise significant regulatory concerns and present significant business and technical challenges. In a scenario where a firm has customer sell limit orders posted at all OCTCs for the applicable NMS stock, the only viable alternative for the firm (assuming there is no midpoint liquidity available) would be to refrain from routing the order to a qualified auction and instead execute the order at the NBO. However, this forecloses any opportunity for price improvement. Presumably, a firm would need to incorporate into its best execution analysis the costs and benefits to the customer of maintaining anonymity, but it could be difficult to justify maintaining anonymity given the applicable restrictions on execution of contra-side orders received by the originating broker, as described above.

One potential solution would be for the OCTC to enforce a new form of self-trade prevention that would apply only when one side is an order that has been submitted to a qualified auction and the originating broker is not attributed, but the rule proposal does not discuss this potential solution. The proposed rule imposes on the originating broker that is seeking to maintain anonymity the obligation to ensure that any party with knowledge of the segmented order does not execute against the segmented order, but the only party with the ability to enforce this restriction is the OCTC. Accordingly, it would be necessary to clarify in the proposed rule that a firm could rely on an OCTC to enforce compliance with this restriction. It would also be necessary to understand if an OCTC would be willing to undertake this responsibility.

Scenario 2: separate desk posts contra-side order on exchange. The NBBO is \$10.00-\$10.05. Customer 1 (C1) transmits to Desk 1 at Originating Broker 1 (OB1) a market order to buy. OB1 routes the buy order to a qualified auction operated by Exchange 1 (E1) with a specified limit price of \$10.04. Desk 2 at OB1 routes to E1 a limit order to sell at \$10.04. OB1 has information barriers in place between Desks 1 and 2.

These two orders could interact in the qualified auction, which would potentially be in violation of the Order Competition rule. However, Desk 1 has no knowledge that the sell order was posted by Desk 2, and Desk 2 has no knowledge that the auction was initiated by Desk 1.

One potential solution would be for the exchange to enforce a form of self-trade prevention that would apply only when one side is an order that has been submitted to a qualified auction and the originating broker is not attributed, but the rule proposal does not discuss this potential solution. The rule imposes the regulatory obligation on the firm routing the segmented order to the qualified auction even though this firm has no way to ensure compliance.

Another potential solution would be for the Commission to provide additional clarity as to what is meant by "knowledge". In this scenario, ABC Broker-Dealer has knowledge of the segmented order, but Desk 2 does not have knowledge of the segmented order. The Commission could clarify that knowledge should be attributed at the desk level rather than at the broker-dealer level, assuming that appropriate information barriers are in place.

Scenario 3: separate desk receives auction message. The NBBO is \$10.00-\$10.05. Customer 1 (C1) transmits to Desk 1 at OB1 a market order to buy. OB1 routes the buy order to a qualified auction operated by Exchange 1 (E1) with a specified limit price of \$10.04. E1 disseminates an auction message. Desk 1 could be in violation of this Order Competition Rule if Desk 2 responds to the auction.

The discussion for Scenario 2 applies for this scenario as well.

Scenario 4: multiple routes. Scenarios 1 through 3 involve orders with one route, but an order can have multiple routes. The NBBO is \$10.00-\$10.05. Customer 1 (C1) transmits to Originating Broker 1 (OB1) a market order to buy. OB1 routes the order to Routing Broker 1 (RB1). RB1 routes the order to Market Maker 1 (MM1). MM1 routes the order to a qualified auction operated by Exchange 1 (E1) with a specified limit price of \$10.04.

The first problem that this scenario presents is that OB1 would have no way to prevent RB1 or MM1 from participating in the qualified auction and would have no way to monitor whether RB1 and MM1 are complying with this restriction. Even after execution, OB1 would not know whether RB1 or MM1 was the counter-party in the qualified auction. This means that OB1 could be in violation of proposed Rule 615(e)(3) without being aware of such violation or having any ability to monitor for compliance.

A second and distinct challenge is that RB1 would be prohibited from participating in the auction but would have no way to know that the auction is for the order that it routed unless MM1 communicates to RB1 the auction identifier assigned by E1. Similarly, OB1 would be prohibited from participating in the auction but would have no way to know that the auction is for the order that it routed unless MM1 communicates to RB1 the auction identifier assigned by E1 and RB1 communicates this identifier to OB1. RB1 and OB1 would need to maintain tables with all qualified auctions that they are prohibited from responding to and process these tables prior to responding to any qualified auction message.

Alternatively, every firm in the chain could pass its firm identifier to the next downstream firm with the direct submitter to the auction passing all upstream firm identifiers (along with the submitter's own firm identifier) to the OCTC. The OCTC would then need to block any execution against any such identified firms. These processes should be addressed in the rule proposal.

Scenario 5: auction participation by broker-dealer that operates ATS. The NBBO is \$10.00-\$10.05. Customer 1 (C1) transmits to OB1 a market order to buy. OB1 routes an IOC order to ATS 1 (ATS1) for a mid-point execution. ATS1 does not execute the mid-point order. OB1 routes the order to a qualified auction operated by Exchange 1 (E1).

OB1 cannot prevent the broker-dealer that operates ATS1 (BD1) from participating in the auction and would have no way to monitor whether BD1 is complying with this restriction. Even after execution, OB1 would not know whether BD1 was the counter-party in the qualified auction.

One potential solution would be for the Commission to clarify, as discussed above, that knowledge should be attributed at the desk level rather than at the broker-dealer level, assuming that appropriate information barriers are in place.

Originating broker certification requirement

Under proposed Rule 615(c)(1)(iii), to qualify for non-attribution, the originating broker must certify that “... it has established, maintained, and enforced written policies and procedures reasonably designed to assure that ...” its identity “... will not be disclosed, directly or indirectly, to any person that potentially could participate in the qualified auction or otherwise trade with the segmented order”⁶² As a further condition, the originating broker’s certification must be “communicated to the open competition trading center conducting the qualified auction.”⁶³ FIF members request clarification whether this certification is intended as an order-level certification that would be tagged with each order message, whether this certification is intended as a firm-level certification, or whether the Commission intends to permit either approach. More generally, can an originating broker elect to be attributed for some, but not all, orders?

Which firm should be attributed?

The proposed rule would effectively define the originating broker to include both the introducing firm and the clearing firm for an account as the originating broker.⁶⁴ As discussed above, FIF members disagree with this approach because the clearing firm should not be considered an originating broker when it has no involvement in the handling of an order. While the proposed rule would allow an introducing firm and a clearing firm to allocate the originating broker responsibilities by written agreement,⁶⁵ there is no reason that a clearing firm should have to enter into such an agreement. Accordingly, the baseline rule should be that the introducing firm should be the originating broker.

While FIF members recommend this as the baseline rule, FIF members agree with the Commission’s approach for the specific scenario where an introducing firm routes all of its orders to its clearing firm (in other words, the introducing firm effectively outsources its trade execution function to its clearing firm). In this scenario, the introducing firm and the clearing firm should have the right to agree between themselves in writing as to which firm should be attributed. Absent such written agreement, the introducing firm should be attributed.

As proposed by the Commission, there are two sets of core obligations that would apply to an originating broker:

- The set of obligations relating to identification of segmented accounts

⁶² Proposed Rule 615(c)(1)(iii); Proposing Release, at 393.

⁶³ Ibid.

⁶⁴ Proposed Rule 600(b)(69); Proposing Release, at 390.

⁶⁵ Proposed Rule 615(e)(4); Proposed Release, at 397.

- The set of obligations relating to attribution (including restrictions that would need to be applied to comply with the conditions for non-attribution).

FIF members recommend that the first set of obligations be imposed on the introducing firm consistent with the traditional role of an introducing broker. FIF members recommend that the second set of obligations be imposed on the introducing broker except in the scenario where the introducing broker routes all of its orders to its clearing firm and the clearing firm has agreed to undertake the obligations relating to attribution.

BB. Obligations of broker-dealers

The proposed rule prohibits any broker or dealer with knowledge of where a segmented order is to be routed for execution to “... submit an order, or enable an order to be submitted by any other person, to the continuous order book of an open competition trading center or of a national securities exchange that could have priority to trade with the segmented order at such open competition trading center or national securities exchange.”⁶⁶ FIF members request guidance on what is meant by “priority to trade” for purposes of this provision.

CC. Obligations of national securities exchanges

The proposed rule provides that “[A] national securities exchange shall not operate a system, other than a qualified auction, that is limited, in whole or in part, to the execution of segmented orders...”, unless an applicable exception applies.⁶⁷ Because a firm can route a segmented order to execute against an order posted on an exchange limit order book, an exchange limit order book will necessarily execute segmented orders, which would appear to be in violation of this provision. FIF members do not believe that this is the Commission’s intent. FIF members request that the Commission update the wording of the proposed rule to address this point.

DD. Execution by ATS at mid-point based on when order is received by ATS

Assume the following scenario: the NBBO is \$10.00-\$10.02 at the time that Originating Broker 1 (OB1) receives a market order to buy from Customer 1 (C1); the NBBO changes to \$10.01-\$10.03; OB1 routes a mid-peg IOC order to ATS 1 (ATS1); ATS1 executes the order at \$10.02. This would appear to be permitted because “[T]he segmented order is executed by the restricted competition trading center at a price that is equal to or more favorable for the segmented order than the midpoint of the national best bid and national best offer when the segmented order is received by the restricted competition trading center.”⁶⁸ FIF members request clarification whether the ATS would be permitted to execute the segmented order at \$10.02 in this scenario.

⁶⁶ Proposed Rule 615(f)(2); Proposing Release, at 397-398.

⁶⁷ Proposed Rule 615(g); Proposing Release, at 398.

⁶⁸ Proposed Rule 615(b)(3); Proposing Release, at 393.

EE. Auction fees

If a segmented order executes in a qualified auction against a displayed order on the OCTC's limit order book, in many cases the OCTC, based on its fee structure, would need to pay a fee to the displayed order. At the same time, under the proposed rule, the OCTC is not permitted to charge a fee to the firm that submits the segmented order.⁶⁹ Does this mean that the OCTC would be required to lose money on this trade? Alternatively, is an OCTC permitted to update its rules to provide that a displayed order that normally receives a rebate if executed would need to pay a fee if it executes against a segmented order submitted to a qualified auction? Could an OCTC then permit its participants to elect not to execute against segmented orders in a qualified auction? FIF members request that the Commission provide additional guidance on these questions, including the rationale for such guidance. These are important issues to address in any reissuance of the proposed rule.

FF. Interrelation with Order Protection rule

FIF members request that the Commission provide guidance on the interrelation between the proposed Order Competition rule and the Commission's Order Protection rule.⁷⁰ There are at least two scenarios to consider.

In the first scenario, the NBBO moves away from the customer order. For example, consider a scenario where a customer submits a buy order when the NBBO is \$10.00-\$10.02. The order is a segmented order. The originating broker submits the segmented order to a qualified auction with a specified limit price of \$10.02. During the auction period, the NBBO changes to \$10.03-\$10.05. Is the OCTC that operates the auction required to cancel the qualified auction at this point? Is the OCTC permitted to cancel the qualified auction at this point? Is the OCTC permitted (or required) to wait until the end of the qualified auction period and then required to cancel the qualified auction if the specified limit price is outside the NBBO at that time? FIF members request that the Commission provide guidance on this scenario and its rationale for such guidance.

In the second scenario, the NBBO moves away from the responders. For example, consider a scenario where a customer submits a buy order when the NBBO is \$10.00-\$10.02. The order is a segmented order. The originating broker submits the segmented order to a qualified auction with a specified limit price of \$10.02. During the auction period, the NBBO changes to \$9.99-\$10.01. Is the OCTC that operates the auction required to cancel the auction at this point? Is the OCTC that operates the auction permitted to cancel the qualified auction at this point? Is the OCTC permitted (or required) to wait until the end of the auction period and then required to cancel the auction if the specified limit price is outside the NBBO at that time and there is no auction response that is within the NBBO? FIF members request that the Commission provide guidance on this scenario and its rationale for such guidance.

⁶⁹ Proposed Rule 615(c)(4); Proposing Release, at 394.

⁷⁰ 17 CFR §242.611.

More generally, FIF members request guidance as to whether an OCTC could permit a firm to submit a segmented order with a specified limit price that is outside the NBBO. FIF members request that the Commission provide guidance on this question and its rationale for such guidance. Conversely, is an OCTC permitted to accept an auction response that is outside the NBBO?

Assuming that executions outside the NBBO would be permitted in a qualified auction, FIF members request that the Commission provide detailed guidelines regarding the possible interactions between the proposed rule and the Order Protection Rule, including what would happen if a qualified auction would trade through a protected quote on an “away” market. Would the auction submitter be required to send ISOs to sweep protected quotes? FIF members note that if an auction submitter is required to sweep protected quotes, the auction submitter presumably would need to incur a fee for these executions, which would be contrary to the requirement in the proposed rule that “[N]o fee shall be charged for submission or execution of a segmented order.”⁷¹

GG. Trading halts, limit up-limit down and circuit breakers

FIF members request that the Commission provide clarity on how a trading halt, limit state, straddle state or circuit breaker would impact the operation of a qualified auction. For example, assume that a stock is subject to Rule 201 of Regulation SHO, such that an OCTC is not permitted to execute or display a short sale order in the stock at a price that is less than or equal to the current NBB.⁷² Assume that when a firm submits a segmented short sell order to a qualified auction the specified price is above the NBB. Assume further that during the qualified auction the NBB increases such that the specified price is now equal to the NBB. Is the OCTC required to cancel the qualified auction? Is the OCTC permitted to wait until the end of the qualified auction to make this determination?

HH. Error corrections

It is unclear how a firm could trade out of an error without violating the order competition requirement. For example, assume that an originating broker receives a limit order to buy from a customer when the NBBO is \$10.00 - \$10.02. Assume the originating broker mistakenly processes the order as a sell. To resolve the customer side of this error, the originating broker must execute a principal sell to the customer at \$10.02. How could the originating broker process this trade correction without violating the order competition requirement?

II. Fractional share orders

A similar question arises for other scenarios where an originating broker trades as principal to accommodate a particular customer workflow. For example, it is not clear how an originating broker could trade a fractional share order (or the fractional share portion of a mixed lot order) as principal without violating the order competition requirement. Firms need to aggregate fractional shares because

⁷¹ Proposed Rule 615(c)(4); Proposing Release, at 394.

⁷² 15 U.S.C. §242.201(b)(1).

DTCC does not allow for settlement of fractional shares. This requires the originating broker (or a market maker that agrees to take on this fractional share position) to trade as principal.

As a separate concern, the proposed rule contemplates that a qualified auction could execute a fractional share order, but it is not clear how a fractional share trade executed on an OCTC could be settled.⁷³ FIF members request clarification on this point.

JJ. Multi-leg order with an equity leg; other contingent orders

It is unclear how an originating broker could achieve execution for a customer multi-leg order that has an equity leg. For a multi-leg order with an equity leg, the execution of the options and equity legs are contingent on each other. The standard practice for execution of these orders is for an options and equity market maker to execute simultaneously against all legs of the customer multi-leg order. This would not be possible if there is a requirement to submit the equity leg of a multi-leg order to a qualified auction. FIF members request that the Commission clarify how an originating broker, under the proposed rule, could achieve execution for a customer multi-leg order that has an equity leg.

In addition to multi-leg orders, there are other types of customer orders, sometimes referred to as “paired” or “contingent” orders, where execution of one order is contingent on simultaneous execution of another order. FIF members request that the Commission clarify how an originating broker, under the proposed rule, could achieve execution for a paired or contingent order.

KK. Pre-open and post-close qualified auctions; opening and closing auctions; orders not executed in an opening auction

The proposed rule does not prohibit an OCTC from operating a qualified auction facility pre-open, post-close, or during the open or close of trading. Does the Commission intend to permit this? If a qualified auction facility were operating during market open or market close, this could potentially prevent exchanges from continuing to operate their current opening and closing auctions because the proposed exception under Rule 615(g)(1) would no longer apply.⁷⁴ Presumably, this is not the Commission’s intent. It is important for the Commission to provide clarity on this point.

It is also unclear what the Commission intends to require when a broker-dealer receives a pre-open limit order from a customer (where the customer instructs that the order can only be executed during regular trading hours), the broker-dealer submits the order to an opening auction, and the order is not executed in the opening auction. Under current exchange rules, the exchange, in this scenario, typically would transfer the order to its continuous order book.⁷⁵ Depending on the customer’s order instructions, the exchange also could route the order to execute against an opposite-side order at another exchange. Would this be permitted, or would the broker-dealer, based on the Commission’s best execution

⁷³ Proposed Rule 615(b)(5); Proposing Release, at 393.

⁷⁴ Proposed Rule 615(g)(1); Proposing Release, at 398.

⁷⁵ See, for example, Cboe, “US Equities Auction Process”, Version 1.5.14 (July 15, 2022), available at https://cdn.cboe.com/resources/membership/Cboe_US_Equities_Auction_Process.pdf, at 13.

discussion in the proposing release, be expected to cancel the order from the exchange and submit the order to a qualified auction facility?

LL. Surveillance

The proposed auction process could provide opportunities for market participants to engage in activity that could be deemed manipulative. The Commission should discuss this potential risk and provide guidance on the obligations of OCTCs, RCTCs, originating brokers and other market participants to surveil for and respond to such activity.

MM. Best execution

A broker-dealer could reasonably determine for a particular order that compliance with the order competition requirement would conflict with the broker-dealer's best execution obligation. Does the Commission intend for the order competition requirement to take precedence in this scenario? If so, the Commission should include an explicit statement to this effect in the proposed rule.

NN. Regulatory reporting

Consolidated Audit Trail

The proposed rule would require changes to various regulatory reporting requirements. Changes for CAT reporting would include: new venues to report; new CAT event types for auction submissions and responses and associated modifications, cancels and executions (or modifications to existing CAT event types to enable reporting of these auction submission and response events); and new fields or handling instructions to reflect data that must be communicated in order messages under the proposed rule. The following are some new fields or handling instructions that could be required (all of these data elements are discussed above in this letter):

- Identification of an order as a segmented order
- Identification that a segmented order was subject to a failed auction
- Identification of an order as customer or broker-dealer order (for all downstream parties and based on how this would be defined for purposes of Rule 615)
- Certification of anonymity
- Identification of the originating broker
- Auction identifier
- Auction-specific self-trade prevention instruction.

In addition to the regulatory reporting changes, all impacted broker-dealers would need to update their systems to communicate and receive these new order-related instructions.

The proposed rule should identify these CAT reporting changes and the implementation timeline for the CAT reporting changes relative to the general implementation timeline for introducing qualified auctions.

Rules 605 and 606

The Commission should discuss in the proposing release whether segmented orders should be reported separately under Rule 606. For Rule 606, a reporting firm that is subject to “look-through” would be required to collect data on additional downstream routing, fee and rebate arrangements to which the reporting firm is not a party.

The Commission also should discuss in the proposing release whether segmented orders should be reported separately under Rule 605 and other changes to Rule 605 reporting that should be adopted based on the proposed Order Competition rule.

OO. Auction performance statistics; other auction statistics

Does the Commission intend to mandate that OCTCs publish daily statistics on executed volume and market quality (such as fill rate, price improvement and time to execution) to assist firms in fulfilling their best execution responsibilities? Under the proposed rule, would OCTCs be permitted to publish, in private data feeds, statistics (such as number of auction responses) for an individual auction or aggregated across multiple auctions?

PP. Other scenarios

In this comment letter, we have identified a number of scenarios that require further clarification. We are confident that there are many other scenarios that we have not identified. We urge the Commission to proceed with caution with respect to this proposed rule and ensure that all potential issues, workflows and scenarios are properly considered and vetted prior to any reissuance of the proposed rule and certainly prior to any action being taken.

* * * * *

FIF appreciates the opportunity to comment on the Commission’s Order Competition Rule proposal. If you would like clarification on any of the items discussed in this letter or would like to discuss further, please contact me at howard.meyerson@fif.com.

Very truly yours,

/s/ Howard Meyerson

Howard Meyerson
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