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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. * SR 2022 - * 031

Amendment No. (req. for Amendments *)

Filing by Financial Industry Regulatory Authority

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input checked="" type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
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Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>
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Rule

<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)
<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)
<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010

Section 806(e)(1) *

☐

Section 806(e)(2) *

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Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934

Section 3C(b)(2) *

☐

Exhibit 2 Sent As Paper Document

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Exhibit 3 Sent As Paper Document

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Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Proposed Rule Change to Adopt FINRA Rules 6151 (Disclosure of Order Routing Information for NMS Securities) and 6470 (Disclosure of Order Routing Information for OTC Equity Securities)

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name *	Robert	Last Name *	McNamee
Title *	Associate General Counsel		
E-mail *	robert.mcnamee@finra.org		
Telephone *	(202) 728-8012	Fax	(202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange of 1934, Financial Industry Regulatory Authority has duty caused this filing to be signed on its behalf by the undersigned thereunto duty authorized.

Date 11/16/2022

(Title *)

By Racquel Russell

(Name *)

Senior Vice President and Director of Capital M

Racquel
Russell

Digitally signed by Racquel
Russell
Date: 2022.11.16 17:05:28
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NOTE: Clicking the signature block at right will initiate digitally signing the form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EDFS website.

Form 19b-4 Information *

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FINRA-2022-031 19b-4.docx

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

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FINRA-2022-031 Exhibit 1.docx

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A - Notice of Proposed Rule Change, Security-Based Swap Submission, or Advanced Notice by Clearing Agencies *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2- Notices, Written Comments, Transcripts, Other Communications

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FINRA-2022-031 Exhibit 2a.pdf
FINRA-2022-031 Exhibit 2b.pdf

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

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Exhibit Sent As Paper Document

Exhibit 3 - Form, Report, or Questionnaire

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FINRA-2022-031 Exhibit 3.docx

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

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Exhibit Sent As Paper Document

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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FINRA-2022-031 Exhibit 5.docx

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ the Financial Industry Regulatory Authority, Inc. (“FINRA”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to adopt FINRA Rules 6151 (Disclosure of Order Routing Information for NMS Securities) and 6470 (Disclosure of Order Routing Information for OTC Equity Securities) to require members to (i) publish order routing reports for orders in OTC Equity Securities, and (ii) submit their order routing reports for both OTC Equity Securities and NMS Securities to FINRA for publication on the FINRA website.

The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice. The effective date will be no later than 365 days following publication of the Regulatory Notice announcing Commission approval of the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

3. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

Rule 606(a) of Regulation NMS² (“SEC Rule 606(a)”) requires broker-dealers to publicly disclose specified information about their order routing practices for NMS Securities,³ including for non-directed orders in NMS stocks that are submitted on a “held” basis.⁴ The SEC has stated that, as a result of these disclosures, “customers—and retail investors in particular—that submit orders to their broker-dealers should be better able to assess the quality of order handling services provided by their broker-dealers and whether their broker-dealers are effectively managing potential conflicts of interest.”⁵

FINRA believes these same goals would be furthered by providing investors with similar order handling information for unlisted stocks, which are not covered by the

² 17 CFR 242.606(a).

³ Generally, “NMS Securities” include listed stocks and options, and NMS stocks means any NMS Security other than an option. See 17 CFR 242.600(b).

⁴ See Securities Exchange Act Release No. 84528 (November 2, 2018), 83 FR 58338 (November 19, 2018) (Disclosure of Order Handling Information; Final Rule) (“2018 Amendments Release”). The SEC did not specifically define “held” or “not held” orders, but stated that typically 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. See id. at 58340 n.19. As noted by the SEC in the 2018 Amendments Release, broker-dealers utilize the “held” and “not held” order classifications as a matter of industry practice and to comply with regulatory requirements, including audit trail reporting requirements and the definition of “covered order” in Rule 600(b) of Regulation NMS. See id. at 58344.

⁵ See 2018 Amendments Release, 83 FR 58338, 58423.

existing SEC Rule 606(a) disclosure requirements.⁶ Accordingly, FINRA is proposing to adopt new Rule 6470 to require members to publish quarterly order routing disclosures primarily for non-directed held orders in OTC Equity Securities,⁷ generally aligned with the SEC Rule 606(a) disclosures for NMS stocks but with modifications to account for differences between the market for NMS Securities and over-the-counter (“OTC”) markets, as described below. In addition, to make both the existing SEC Rule 606(a) disclosures and the new OTC Equity Security disclosures more accessible to investors, FINRA is proposing new Rule 6151 and paragraph (d) of new Rule 6470 to require members to send both disclosures to FINRA for centralized publication on the FINRA website, as described further below.

Disclosure of Order Routing Information for OTC Equity Securities

Proposed new Rule 6470, entitled “Disclosure of Order Routing Information for OTC Equity Securities,” would require the publication of order routing disclosures for OTC Equity Securities. Specifically, as is already required for broker-dealers with respect to held orders in NMS stocks under SEC Rule 606(a)(1), proposed Rule 6470(a) would require, among other things, every member to make publicly available for each

⁶ FINRA notes that the SEC’s Equity Market Structure Advisory Committee (“EMSAC”) previously recommended enhancing the current order routing disclosures required under SEC Rule 606 with information about OTC Equity Securities, and also expressed support for centralization of the reports. See EMSAC, Recommendations Regarding Modifying Rule 605 and Rule 606 (November 29, 2016), <https://www.sec.gov/spotlight/emsac/emsac-recommendations-rules-605-606.pdf>.

⁷ An “OTC Equity Security” means any equity security that is not an NMS stock, other than a Restricted Equity Security. See FINRA Rule 6420(f). A “Restricted Equity Security” means any equity security that meets the definition of “restricted security” as contained in Securities Act Rule 144(a)(3). See FINRA Rule 6420(k).

calendar quarter a report on its routing of non-directed orders in OTC Equity Securities that are submitted on a held basis during that quarter, broken down by calendar month, and keep such report posted on an internet website that is free and readily accessible to the public for a period of three years from the initial date of posting on the internet website.⁸ Also in line with the required publication timeframe for NMS stock disclosures under SEC Rule 606(a)(2), proposed Rule 6470(c) would require that a member make the new OTC Equity Security report publicly available within one month after the end of the quarter addressed in the report.⁹

⁸ Proposed Rule 6470 would apply to “every member,” but FINRA notes that the focus of the proposed disclosures is held orders from customers in OTC Equity Securities, and some members may not engage in any activities involving held orders from customers in OTC Equity Securities. If a member does not accept any orders in OTC Equity Securities from customers during a given calendar quarter (whether held or not held), such member would not be required to publish a report under Rule 6470 for that quarter. Similarly, a member that accepted only not held orders in OTC Equity Securities from customers—but no held orders in OTC Equity Securities from customers—during a given calendar quarter would not be required to publish a report for that quarter. See infra note 20. Further, if a member accepted orders in OTC Equity Securities (whether held, not held, or both) only from other broker-dealers, but not from customers, during a given calendar quarter, such member would not be required to publish a report for that quarter.

⁹ FINRA understands that some introducing firms route all of their orders in OTC Equity Securities to one or more clearing firms for further routing to other venues for execution. The SEC has provided guidance that, where an introducing firm routes all of its covered orders to one or more clearing firms for further routing and execution and the clearing firm in fact makes the routing decision, the introducing firm generally may comply with the order routing disclosure requirements by: (i) disclosing its relationship with the clearing firm(s) on its website that includes any payment for order flow received by the introducing firm, and (ii) adopting the clearing firm’s disclosures by reference, provided that the introducing firm has examined the report and does not have reason to believe it materially misrepresents the order routing practices. FINRA intends to provide parallel guidance with respect to proposed Rule 6470. See SEC Division of Trading and Markets, Responses to Frequently Asked Questions Concerning Rule 606 of Regulation NMS, Question 12.01; see also SEC Division of Market

Under Rule 606(a)(1), the SEC Rule 606(a) reports for NMS Securities are required to be broken out into separate sections for NMS stocks in the S&P 500 Index as of the first day of the quarter, other NMS stocks, and NMS Securities that are options. Since these categories are not relevant to the OTC market, FINRA is proposing to instead require that the new quarterly reports for OTC Equity Securities under Rule 6470(a) be separated into three sections to better reflect the OTC market. Specifically, the new reports would be required to be separated into three sections for: (i) domestic OTC Equity Securities; (ii) American Depositary Receipts (“ADRs”) and foreign ordinaries that are OTC Equity Securities; and (iii) Canadian-listed securities trading in the United States as OTC Equity Securities. To provide for consistency across member reports, FINRA will publish a list of the OTC Equity Security symbols that fall under each category, and members would be required to publish reports in a manner consistent with such list.¹⁰

Under Rule 606(a)(1), the SEC Rule 606(a) reports for NMS Securities must be made available using the most recent versions of the XML schema and associated PDF renderer as published on the SEC’s website. Similarly, Rule 6470(a) would specify that the new OTC Equity Security reports must be made available using the most recent versions of the XML schema and associated PDF renderer as published on the FINRA website. FINRA believes this requirement would ensure that reports are generated and published in standardized machine-readable and human-readable forms, which would

Regulation, Staff Legal Bulletin No. 13A, Frequently Asked Questions About Rule 11Ac1-6, Question 4.

¹⁰ If the Commission approves the proposed rule change, FINRA will provide information in the Regulatory Notice announcing the effective date regarding where members may access the list of OTC Equity Security symbols that FINRA will maintain on its website.

benefit investors by permitting the public to more easily analyze and compare the OTC Equity Security reports across members, as well as to more easily perform combined analysis of both SEC Rule 606(a) and OTC Equity Security reports.¹¹

With respect to the content of the new reports, Rule 6470(a) would require that each section of the new OTC Equity Security reports include the information specified in paragraphs (a)(1) through (4) of proposed Rule 6470, specifically:¹²

- the percentage of total orders¹³ for the section that were not held orders and held orders, and the percentage of held orders for the section that were non-directed orders;¹⁴

¹¹ FINRA would publish the technical specifications for the XML schema and associated PDF renderer on its website for member use in generating the new reports. FINRA expects that, subject to the differences between the SEC Rule 606(a) reports and the OTC Equity Security reports discussed above, the XML schema and associated PDF renderer published by FINRA would be substantially similar to those published by the SEC for the SEC Rule 606(a) reports.

¹² A template of the proposed new OTC Equity Security report that would be required under proposed Rule 6470 is attached as Exhibit 3.

¹³ For purposes of proposed Rule 6470(a), “total orders” would include all orders from customers for the section, including both directed and non-directed orders from customers.

¹⁴ For purposes of the proposed disclosures, a “non-directed order” would mean any order from a customer other than a directed order. Consistent with the definition of “directed order” under Regulation NMS, a “directed order” would mean an order from a customer that the customer specifically instructed the member to route to a particular venue for execution. See 17 CFR 242.600(b); see also 2018 Amendments Release, 83 FR 58338, 58339 n.4. FINRA notes that, similar to the definition of “customer” under Rule 600(b)(23) of Regulation NMS, a “customer” is defined under FINRA rules to exclude a broker or dealer. See FINRA Rule 0160(b)(4). Orders from other broker-dealers would therefore be excluded from the proposed disclosures.

- the identity of the ten venues to which the largest number of total non-directed held orders for the section were routed for execution¹⁵ and of any venue to which five percent or more of non-directed held orders for the section were routed for execution, and the percentage of total non-directed held orders for the section routed to the venue;¹⁶

¹⁵ Consistent with the SEC’s approach to SEC Rule 606(a), FINRA intends that, for purposes of the proposed disclosures for OTC Equity Securities, a “venue” would be defined broadly to cover any market center or any other person or entity to which a member routes orders for execution. See, e.g., Securities Exchange Act Release No. 43590 (November 17, 2000), 65 FR 75414, 75427 n.63 (December 1, 2000) (Disclosure of Order Execution and Routing Practices) (“The term ‘venue’ is intended to be interpreted broadly to cover ‘market centers’ within the meaning of Rule 11Ac1–5(a)(14) [now Rule 600(b)(46) of Regulation NMS], as well as any other person or entity to which a broker routes non-directed orders for execution. Consequently, the term excludes an entity that is used merely as a vehicle to route an order to a venue selected by the broker-dealer.”); see also 17 CFR 242.600(b)(46) (“Market center means any exchange market maker, OTC market maker, alternative trading system, national securities exchange, or national securities association.”). Accordingly, for purposes of proposed Rule 6470, where an alternative trading system (“ATS”) offers both automatic order execution and order delivery functionality, the ATS should be identified as the venue only when the ATS provides order execution. FINRA believes identification of the ATS in these circumstances is appropriate because the ATS is the venue where the order was routed “for execution,” consistent with SEC guidance for the predecessor to SEC Rule 606. See SEC Division of Market Regulation, Staff Legal Bulletin No. 13A, Frequently Asked Questions About Rule 11Ac1-6, Question 12. Conversely, for purposes of proposed Rule 6470, in cases where the ATS instead provides order delivery, the separate market center to which the orders are delivered—e.g., a market maker or other ATS—should be identified as the venue where the order was routed for execution.

¹⁶ However, the proposed rule change would include a de minimis venue exception parallel to exemptive relief that the SEC has provided with respect to the SEC Rule 606(a) reports. See Letter from Annette L. Nazareth, Director, SEC Division of Market Regulation, to Neal E. Sullivan & Gail Marshall-Smith, Bingham Dana LLP (on behalf of First Union Securities, Inc.), dated June 22, 2001, 2001 SEC No-Act. LEXIS 903; see also SEC Division of Market Regulation, Staff Legal Bulletin No. 13A, Frequently Asked Questions About Rule 11Ac1-6, Question 2. Specifically, proposed Rule 6470(b) would provide an exception from the requirement for a member to identify venues that received less

- for each identified venue, the net aggregate amount of any payment for order flow received, payment from any profit-sharing relationship received, transaction fees paid, and transaction rebates received, both as a total dollar amount and per order, for all non-directed held orders for the section; and
- a discussion of the material aspects of the member's relationship with each identified venue, including, without limitation, a description of any arrangement for payment for order flow and any profit-sharing relationship and a description of any terms of such arrangements, written or oral, that may influence a member's order routing decision including, among other things: incentives for equaling or exceeding an agreed upon order flow volume threshold, such as additional payments or a higher rate of payment; disincentives for failing to meet an agreed upon minimum order flow threshold, such as lower payments or the requirement to pay a fee; volume-based tiered payment schedules; and agreements regarding the minimum amount of order flow that the member would send to a venue.¹⁷

than 5% of non-directed held orders for a section, provided that the member has identified the top execution venues that in the aggregate received at least 90% of the member's total non-directed held orders for the section.

¹⁷ Similar to SEC Rule 606(a), the types of arrangements referenced above are not an exhaustive list of terms of payment for order flow arrangements or profit-sharing relationships that may influence a broker-dealer's order routing decision that would be required to be disclosed. For example, if a broker-dealer receives a discount on executions in other securities or some other advantage in directing order flow in a specific security to a venue, or if a broker-dealer receives equity rights in a venue in exchange for directing order flow there, then all terms of those arrangements would also be required to be disclosed. Similarly, if a broker-dealer receives variable payments or discounts based on order types and the number of orders sent to a venue, such arrangements would be required to be disclosed. See 2018 Amendments Release, 83 FR 58338, 58376 n.397. However, FINRA notes that these are only examples, and a member would be required to disclose any other material aspects of its relationship with each identified venue regardless of

The proposed content of the new OTC Equity Security reports under proposed FINRA Rule 6470(a) generally parallels the content required to be included in SEC Rule 606(a) reports for NMS stocks pursuant to SEC Rule 606(a)(1)(i) through (iv), with the following differences to take into account the different market structure and characteristics of OTC Equity Securities. First, Rule 6470(a)(1) would require members to disclose the percentage of total orders for the section that were not held orders and held orders, in addition to disclosing the percentage of held orders for the section that were non-directed orders.¹⁸ While SEC Rule 606(a) similarly requires broker-dealers to disclose the percentage of orders for each section that were non-directed orders, it does not require broker-dealers to disclose the percentage of total orders for each section that were not held orders and held orders.¹⁹ FINRA believes that requiring members to provide information about the relative amount of a member's held and not held orders in the new reports proposed to be published under Rule 6470(a)(1) would provide investors, regulators, academics, and others seeking to review the reports with additional information regarding the business of brokers active in the OTC market.²⁰

whether a particular example is listed in the proposed rule text or otherwise discussed in this proposed rule change.

¹⁸ See notes 13 and 14 supra.

¹⁹ SEC Rule 606(b)(1) provides that customers may request customer-specific information about the handling of both their held and not held orders, and SEC Rule 606(b)(3) provides that customers may request additional customer-specific information about the handling of their not held orders. FINRA is not proposing parallel customer-specific disclosure requirements for OTC Equity Securities at this time.

²⁰ The proposed requirement to disclose the percentage of total orders for each section that were not held orders and held orders is the only disclosure requiring any information regarding not held orders, as the remainder of the proposed

Second, the information required to be disclosed under SEC Rule 606(a)(i) through (iii) is required to be broken out into sections for market orders, marketable limit orders, non-marketable limit orders, and other orders. However, FINRA is not adopting these categories for OTC Equity Securities due to the absence of a centralized, self-regulatory organization (SRO)-disseminated national best bid and offer in the OTC market on which to standardize and base marketability. Finally, SEC Rule 606(a)(1)(iii) requires the disclosure of quantitative payment information both as a total dollar amount and per share. In light of different pricing practices in the OTC market, Rule 6470(a)(3) would instead require the quantitative disclosures for OTC Equity Securities to be expressed as both a total dollar amount and per order (rather than per share).²¹

Centralized Hosting of Order Routing Disclosures

As discussed above, SEC Rule 606(a) requires broker-dealers to publish their SEC Rule 606(a) reports for NMS Securities on an internet website that is free and readily accessible for at least three years, and proposed FINRA Rule 6470 would similarly require the new OTC Equity Security reports to be published on a website that is free and readily accessible for at least three years. Currently there is not one location where all SEC Rule 606(a) reports are consolidated, although FINRA understands some

disclosures apply exclusively to held orders. If a member did not accept any held orders in OTC Equity Securities from customers in a given calendar quarter, it would not be required to publish a report under proposed Rule 6470 for that quarter (even if it accepted orders on a not held basis during that quarter). See note 8, supra.

²¹ For example, FINRA understands that, unlike in the market for NMS Securities where payment for order flow is typically paid as a specified dollar amount per share, payments in the OTC market are predominantly made on a per order basis (with rates typically bucketed by share price category).

broker-dealers use vendors that make their client broker-dealers' reports available through common vendor pages. Thus, regulators, investors and others seeking to review the reports often must locate and obtain the reports from various individual broker-dealer or vendor websites.

To make both the existing Rule 606(a) reports and the new OTC Equity Security reports more accessible for regulators, investors and others seeking to analyze and compare the data, FINRA is proposing to require that members provide the reports to FINRA for central publication on the FINRA website (in addition to posting on a public website for at least three years, as required under Rule 606(a) and proposed Rule 6470(a)).²² Specifically, paragraph (d) of proposed new Rule 6470 would require each member to provide the OTC Equity Security report to FINRA within one month after the end of the quarter addressed in the report in such a manner as may be prescribed by FINRA.²³ Proposed new Rule 6151, entitled "Disclosure of Order Routing Information for NMS Securities," would similarly require each member that is required to publish a report pursuant to SEC Rule 606(a) to provide the report to FINRA, in the manner

²² FINRA also intends to engage in investor education efforts to help investors and others understand the purpose, content, and potential limitations of the disclosures.

²³ FINRA would specify details regarding the manner of submission of the reports to FINRA in a Regulatory Notice or similar publication. Members would be permitted to use a third-party vendor to assist with both the generation of the reports and transmission to FINRA. However, the member would remain responsible for the reports in all respects, including the accuracy of the disclosures and the timeliness and completeness of the submissions to FINRA. Accordingly, a member would be required to submit a corrected report to FINRA (and publish a corrected report on its publicly accessible website) promptly following the discovery of inaccurate data or other error in a previously submitted or posted report.

prescribed by FINRA, within the same time and in the same formats that such report is required to be made publicly available pursuant to SEC Rule 606(a) (i.e., one month after the end of the calendar month addressed in the report). Under both provisions, FINRA would publish such reports on its public website. FINRA will publish both the SEC Rule 606(a) and OTC Equity Security reports in a centralized location on the FINRA website, free of charge and with no restrictions on use of the data.²⁴

As noted in Item 2 of this filing, if the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice. The effective date will be no later than 365 days following publication of the Regulatory Notice announcing Commission approval of the proposed rule change.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,²⁵ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote

²⁴ As noted above, the SEC has provided guidance that introducing firms may comply with Rule 606(a) by incorporating their clearing firm(s) reports in specified circumstances, and FINRA intends to provide similar guidance with respect to the OTC Equity Security reports required under proposed Rule 6470. See supra note 9. To facilitate centralized access to the reports, such introducing firms must provide FINRA with a list of their clearing firm(s) and the hyperlink to the webpage where they disclose their clearing firm relationship(s) and adopt the clearing firm(s)'s reports by reference. Each introducing firm relying on this guidance would be required to provide this information to FINRA upon implementation of the proposed rule change and to update FINRA if the information previously provided changes. This information will enable FINRA to provide investors with relevant information for all firms, including introducing firms incorporating clearing firm reports by reference, on FINRA's website.

²⁵ 15 U.S.C. 78o-3(b)(6).

just and equitable principles of trade, and, in general, to protect investors and the public interest.

FINRA believes that the proposed requirement for members to publish order routing disclosures for OTC Equity Securities, similar to what is available under SEC rules for NMS Securities, would provide valuable information for investors and other market participants, academics, regulators and others regarding order routing practices in the OTC market, thereby enhancing the protection of investors and the public interest. In particular, these new disclosures will enable investors to better assess the quality of their broker-dealers' order handling services for these securities, provide more information on the financial incentives that may affect their broker-dealers' routing decisions, and allow investors to better evaluate whether their broker-dealers are effectively managing potential conflicts of interest. The proposed requirements for members to send their disclosure reports for both NMS Securities and OTC Equity Securities to FINRA for centralized publication on the FINRA website will make this important information more accessible for regulators, investors, academics and others seeking to analyze and compare the data, particularly across firms, and would facilitate the ability of FINRA and the SEC to review the data for regulatory purposes.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

Economic Impact Assessment

Based on the regulatory need discussed above and summarized below, FINRA has undertaken an economic impact assessment, as set forth below, to analyze the potential economic impacts of the proposed rule change, including potential costs, benefits, and distributional and competitive effects, relative to the current baseline.

Regulatory Need

FINRA believes that in today's markets, where various incentives may impact broker-dealers' order handling decisions, customers have limited access to relevant information to help them assess how their orders are handled, and that different customers may have access to different amounts or categories of relevant information. The proposed requirement for members to publish quarterly order routing disclosures for non-directed held orders in OTC Equity Securities is designed to provide investors with information to better assess the quality of order handling services provided by their broker-dealers and whether their broker-dealers are effectively managing potential conflicts of interest. In addition, requiring members to send both the existing SEC Rule 606(a) disclosures and the proposed OTC Equity Security disclosures to FINRA for centralized publication on the FINRA website would make these disclosures more accessible to investors and others relevant stakeholders.

Economic Baseline

Between October 1 and December 31, 2020, there were 85, 76, and 55 firms²⁶ quoting domestic OTC Equity Securities, ADRs and foreign ordinaries that are OTC

²⁶ A "firm" is any FINRA member that has a Central Registration Depository number.

Equity Securities, and Canadian-listed securities trading in the U.S. as OTC Equity Securities, respectively. The average number of symbols quoted per firm in each of these respective security categories was: 496, 681, and 260. Furthermore, the average number of quote events per symbol and firm, 37,831, was the largest for Canadian-listed securities that trade OTC in the U.S. as compared to 1,203 for domestic and 25,105 for ADRs and foreign ordinaries.

There are more firms executing trades than providing quotes in OTC Equity Securities. In the fourth quarter of 2020, there were 261, 250, and 196 firms executing trades in domestic, ADRs and foreign ordinaries, and Canadian-listed securities trading in the U.S. as OTC Equity Securities, respectively. The average number of symbols traded per firm was 287, 491, and 195, and the average number of executions per symbol and per firm was 1,215, 1,082, and 1,381 for these respective security categories. Although the average number of executions per symbol per firm was largest for Canadian-listed securities, the average dollar volume per symbol and per firm was largest for the ADRs and foreign ordinaries at \$7,687,626, as compared to \$3,621,871 for domestic and \$2,660,868 for the Canadian-listed securities that trade OTC in the U.S. This reflects the generally lower prices for domestic OTC Equity Securities and Canadian-listed securities that trade OTC in the U.S. as compared to ADRs and foreign ordinary shares.

In the fourth quarter of 2020, there were 560, 573, and 444 firms that routed orders in domestic OTC Equity Securities, ADRs or foreign ordinaries, and Canadian-listed securities that trade as OTC Securities in the U.S, respectively, with approximately 600 unique firms total across the three categories. These numbers represent the potential upper bound on the number of firms by security category that could be required to

provide the proposed disclosure reports, as some firms may not handle orders from customers (based on fourth quarter of 2020 data). The average number of symbols routed per firm is 104, 180, and 67, and the average number of orders per symbol and per firm is 170, 124, and 134 for each of the three security categories. Consequently, the largest average number of symbols routed per firm was for ADRs and foreign ordinaries, but the average number of orders per symbol per firm was largest for domestic OTC Equity Securities.

FINRA believes that, at present, customers receive limited information on how members route their orders in OTC Equity Securities, any payments that members receive from execution venues related to the routing of these orders, and the relative order execution quality by member or execution venue. In the absence of regulatory disclosure requirements, any information that customers do receive may be selectively provided to individual customers and is likely not comparable across firms. Moreover, larger customers may receive more information relative to smaller customers, thereby giving the former an informational advantage. OTC Equity Security routing data is currently not required to be publicly available, and no studies have been conducted on the quality of order handling services provided by firms for such securities.

There are, however, studies that examine the benefits of transparency around the implementation of Rules 605²⁷ and 606 of Regulation NMS with respect to member

²⁷ Under Rule 605 (formerly 11Ac1-5), the SEC requires market centers that trade NMS Securities to make monthly electronic reports. These reports include information about each market center's quality of executions on a stock-by-stock basis, including how market orders of different sizes are executed relative to the public quotes. These reports also disclose information about effective spreads and the extent to which executions occur at prices better than the public quotes for marketable orders.

routing and venue execution quality for NMS stocks. These studies may inform the potential economic impacts from transparency in the market for OTC Equity Securities, although, as noted above, there are significant differences between the market for NMS Securities and OTC Equity Securities. In addition, as Rules 605 and 606 went into effect at approximately the same time, these studies are unable to distinguish the separate effects of order execution quality disclosure under Rule 605 and that of order routing disclosure under Rule 606 on activity in NMS stocks. After implementation of Rule 605, effective and quoted spreads for NYSE-, AMEX-, and NASDAQ-listed stocks declined significantly.²⁸ In addition, the implementation of Rules 605 and 606 resulted in broker-dealers increasingly routing orders in NMS stocks to venues that offered better execution quality on the dimensions of effective spreads and fill rates, which suggests these reports contain information that appears useful in routing decisions.²⁹

Studies analyzing the market for NMS stocks indicate that broker-dealers may route orders to maximize order flow payments by sending market orders to venues making payments and sending limit orders to venues paying large liquidity rebates. Such routing may not always be in customers' best interests. Make-take fees may lead to agency conflicts and rebate volume pricing tiers may worsen such conflicts further.³⁰

²⁸ See Xin Zhao & Kee H. Chung, Information Disclosure and Market Quality: The Effect of SEC Rule 605 on Trading Costs, 42 *The Journal of Financial and Quantitative Analysis*, 657-682 (2007).

²⁹ See Ekkehart Boehmer, Robert Jennings, & Li Wei, Public Disclosure and Private Decisions: Equity Market Execution Quality and Order Routing, 20 *Review of Financial Studies*, 315–358 (2007).

³⁰ See James J. Angel, Lawrence E. Harris & Chester S. Spatt, Equity Trading in the 21st Century,” 1 *Quarterly Journal of Finance*, 1–53 (2011); Chester S. Spatt, Is

Theoretical models of the conflict between investors and their broker-dealers, who may be incentivized to route orders based on the take fees charged or rebates paid by exchanges, find that the conflict of interest reduces investor utility.³¹ Using Rule 606 data, one study examined broker-dealer routing of non-marketable limit orders in NMS stocks to exchanges offering the largest rebate. This analysis combined with proprietary limit order data found that low-fee (i.e., low-rebate) exchanges fill or fill more rapidly when high-fee (i.e., high-rebate) exchanges do not fill, and non-marketable limit orders earn higher average realized spreads on low-fee than high-fee exchanges.³²

In the absence of the proposed disclosures, investors may not know where a broker-dealer routes orders for execution or whether the broker-dealer receives payments or rebates from such venues. In addition, in the absence of order routing and payment for order flow information, customers may not possess information necessary to assist them in forming a preference concerning their brokers' routing choices—particularly where customer commission charges have been reduced or eliminated. Furthermore, if customers have information on how brokers route orders and are able to negotiate commissions to more closely represent the broker-dealer's average execution cost for a particular customer's order flow, then customers may be better able to submit the mix of liquidity-supplying and demanding orders to minimize commissions and improve order

Equity Market Exchange Structure Anti-Competitive? (Dec. 28, 2020) Working Paper.

³¹ See David A. Cimon, Broker Routing Decisions in Limit Order Markets, 54 Journal of Financial Markets, 1386-4181 (2021).

³² See Robert Battalio, Shawn A. Corwin & Robert Jennings, Can Brokers Have It All? On the Relation Between Make-Take Fees and Limit Order Execution Quality, 71 The Journal of Finance, 2193–2238 (2016).

execution.³³ Even where customers are unable to negotiate fees, agency issues related to order flow payments may be reduced or eliminated if investors know where their orders are routed. As noted above, while these studies examine the benefits of transparency with respect to NMS stocks and there are significant differences between the market for NMS Securities and the market for OTC Equity Securities, these studies may inform analysis of the potential impacts of the proposed disclosure on the OTC market.

Economic Impacts

Anticipated Benefits

Under the proposed rule change, customers would have more information on the financial incentives that may affect their firms' routing decisions, because the reports would identify the net aggregate amount of any payment for order flow received, payment from any profit-sharing relationship received, transaction fees paid, and transaction rebates received by their firms.

At present, in the absence of order routing reports, customers may be less able to consider indirect costs that may impact execution quality than direct trading costs, such as commissions charged. This is particularly true for retail investors that use the services of zero-commission broker-dealers. Under the proposed rule change, customers may more easily consider indirect and less observable costs, such as transaction fees paid less rebates or payment for order flow, and better assess potential conflicts of interest. Brokerage commissions, if charged, may depend on the amount of payment for order flow received and net make-take fees paid by the firm. For example, members that earn

³³ See Shawn M. O'Donoghue, Transaction Fees: Impact on Institutional Order Types, Commissions, and Execution Quality, 60 Journal of Financial Markets (2022).

more payment for order flow may pass a portion of this revenue on to customers by offering lower commissions. However, routing solely to maximize rebates or minimize transaction fees may result in lower execution quality than alternative routing strategies and may raise best execution concerns. Without the proposed disclosures, customers may primarily assess the amount of commissions, if charged, when evaluating brokerage service costs. Customers may pay higher net trading costs should zero or lower commission firms offer inferior execution quality. Standardized reports, which would be available on the member's website and centralized on FINRA's website, would allow customers to compare order routing practices across different firms and observe changes in a firm's routing behavior over time. Customers would be able to better compare indirect trading costs and whether payment for order flow received and net transaction fees paid, considering rebates, may be affecting the routing decisions of some firms more than others or causing changes in routing behavior over time. The information in these reports would permit customers to evaluate firms' routing decisions more effectively and be better informed in making choices among firms. Dividing OTC Equity Securities into separate sections depending on whether they are domestic, ADRs or foreign ordinaries, or Canadian-listed OTC Equity Securities would provide customers with meaningful categories and potentially make the information more useful than if all securities were presented in one group.

FINRA believes that direct benefits to customers stemming from the proposed standardized reports may be limited by a customer's ability to interpret the information in the reports or compare the reports across different members or over time. However, customers may also benefit indirectly through changes in a firm's behavior. A firm may

use the standardized reports to compare its order routing to that of competing firms, and subsequently, to improve its order execution quality. Thus, firms that do not route solely based on payment for order flow received, net transaction fees paid (inclusive of rebates), or provide relatively better order execution quality may better compete for customers based on not receiving rebates or providing better order execution quality.³⁴ In addition, academic or industry researchers may analyze the data in the proposed public reports, which will be centralized on FINRA's website, and make their findings describing differences in broker-dealer routing practices public.

Because FINRA members would be required to submit their existing Rule 606(a) reports to FINRA for central publication on the FINRA website, investors and academic and other industry researchers may more easily access the SEC Rule 606(a) reports, which should make it easier for users to examine data in SEC Rule 606(a) reports across broker-dealers. The reporting and centralization of both the new OTC Equity Security reports and the existing Rule 606(a) reports should also ease FINRA's access to the reported data for regulatory purposes, thereby reducing FINRA's costs.

Anticipated Costs

Members may incur fixed costs, such as programming, to create the initial proposed reports. These initial costs may vary depending on whether firms collect the data and produce the reports in-house or outsource the process to a third party. Members may pay costs to identify which orders are non-directed and submitted on a held basis

³⁴ In light of differences between the market for NMS Securities and the market for OTC Equity Securities, including for example the absence of a centralized, SRO-disseminated national best bid and offer in the OTC market, FINRA is not proposing execution quality disclosure requirements for OTC Equity Securities at this time.

and determine the net aggregate amount of any payment for order flow received and net rebates received in total and per order. To the extent that a member already has systems in place to create reports required for NMS Securities under Rule 606(a), which is probable in most cases, then these initial fixed costs may be relatively lower for such members, although the extent to which these costs would be lower for such firms would depend on the degree to which their existing systems for NMS Securities' disclosures may be used for OTC Equity Securities. Once the system to create the proposed reports is built, there would be fixed costs for maintaining the system and on-going compliance costs, and variable costs for creating and posting the publicly available quarterly reports and for transmitting the reports to FINRA.

In addition, firms that route orders in OTC Equity Securities may re-evaluate their best execution evaluation methodologies and, if deemed beneficial, may choose to incorporate information from the proposed publicly available reports posted by competing firms, which may or may not involve costs to the firm depending on how a firm chooses to use this information.³⁵ Furthermore, as noted by the Commission with respect to new disclosure requirements under Rule 606(b)(3), “[g]iven that broker-dealers will be aware of the metrics to be used a priori, they might route not held orders in a manner that promotes a positive reflection on their respective services but that may be suboptimal for their customers.”³⁶ FINRA notes the same possibility in connection with

³⁵ While firms that route orders in OTC Equity Securities may re-evaluate their best execution evaluation methodologies and incorporate information from the proposed reports, the proposed new OTC Equity Security order routing disclosure reports themselves would not alter a firm's best execution obligations.

³⁶ See 2018 Amendments Release, 83 FR 58338, 58425.

the proposed rule change requiring the disclosure of OTC order handling disclosures. However, FINRA also notes any such effects would be constrained by a firm's obligations under FINRA Rule 5310. In addition, to the extent that the proposal increases costs to members, particularly smaller firms, they may attempt to recoup costs by increasing fees for customers or modifying the scope of services offered for OTC Equity Securities.

Further, if firms stop or limit routing orders to venues paying rebates or making payments for order flow given the existence of the proposed reports, then these venues may reduce or eliminate these financial incentives as volumes decline, which could in turn impact the extent to which a market participant is willing to provide liquidity at such venues, potentially resulting in fewer quotes, wider bid-ask spreads, or fewer shares posted at such venues. In addition, the cost of capital for firms that issue OTC Equity Securities may increase if their securities become less liquid. Because members will be responsible for submitting SEC Rule 606(a) reports currently required for NMS Securities under Regulation NMS to FINRA, they will bear either a direct cost to send the reports to FINRA or an indirect cost if an agent sends the report on their behalf. FINRA believes that introducing firm members that choose to rely on the proposed guidance³⁷ would incur lower costs compared to preparing and providing the actual reports on a quarterly basis on their own or through a third-party vendor.

Alternatives Considered

No other alternatives were considered for the proposed amendments.

³⁷ See supra notes 9 and 24.

5. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The proposed rule change was published for comment in Regulatory Notice 21-35 (October 2021). Five comments were received in response to the Regulatory Notice.³⁸ A copy of the Regulatory Notice is attached as Exhibit 2a. Copies of the comment letters received in response to the Regulatory Notice are attached as Exhibit 2b. The comments are summarized below.

NASAA supported the proposed rule change, stating that it is appropriately tailored to reveal potential conflicts of interest and would bring additional transparency to trading practices in the OTC market.³⁹ NASAA also expressed support for FINRA’s publication of order routing reports on its website, noting that centralization of the reports would allow investors to make comparisons easily, help inform and facilitate regulatory decisions, and help FINRA analyze compliance with the proposed rule, discover best reporting practices to share with its members, perform comparisons to facilitate risk-based examination selections, and determine whether disclosures give rise to the need for

³⁸ See Comment submission from Keith L Hickman, dated October 7, 2021; letter from Howard Meyerson, Managing Director, Financial Information Forum, to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, dated December 2, 2021 (“FIF Letter”); letter from Derrick Chan, Head of Equity Trading and Sales, Fidelity Investments, to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, dated December 6, 2021 (“Fidelity Letter”); letter from Michelle Bryan Oroschakoff, Chief Legal Officer, LPL Financial, to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, dated December 6, 2021 (“LPL Letter”); and letter from Melanie Senter Lubin, President, North American Securities Administrators Association, Inc., to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, dated December 6, 2021 (“NASAA Letter”).

³⁹ See NASAA Letter at 1-3.

investigation.⁴⁰ FINRA agrees and, as discussed above, is proposing to publish both the new OTC Equity Security reports and existing SEC Rule 606(a) reports in a centralized location on its website, free of charge and without usage restrictions. Finally, NASAA expressed its belief that investor education is necessary to make the reports useful, and accordingly suggested that FINRA develop and post information for investors on how to read and interpret the data. Alternatively, NASAA suggested that FINRA could develop standard educational materials that firms can either link to or be required to make available with the reports.⁴¹ FINRA agrees that investor education would be useful and, as noted above, intends to engage in investor education efforts regarding the purpose, content, and potential limitations of the disclosures.⁴²

Fidelity also supported the proposed rule change, stating that it largely accomplishes the goals of providing transparency into broker routing and economic practices in OTC Equity Securities, an asset class that has experienced significant growth but remains opaque.⁴³ Fidelity also made several recommendations to enhance the effectiveness of the proposed rule change. First, Fidelity recommended that FINRA and the SEC should consider how various order routing disclosure reports, including SEC Rules 605 and 606 reports, are used in the marketplace and could be used together, suggesting that FINRA and the SEC should coordinate their oversight of order routing

⁴⁰ See supra note 39 at 3-4.

⁴¹ See supra note 39 at 5.

⁴² See supra note 22.

⁴³ See Fidelity Letter at 1-2.

reports to ensure consistency in process and interpretation.⁴⁴ FINRA agrees with and, as described above, has sought to align the form and content of the new OTC Equity Security reports as closely as possible with the existing Rule 606(a) reports, unless there was a reason for the content to differ due to the unique characteristics of the OTC market. FINRA believes that this approach will assist in ensuring consistency in the process for generating the reports and regulatory interpretation concerning the reporting framework. FINRA also expects to continue its engagement with the SEC regarding order routing and execution quality information more broadly.

Second, Fidelity recommended that FINRA make publicly available a list of OTC Equity Securities appearing in each section of the proposed OTC Equity Security reports, and provide further clarity concerning the definition of market center and fees to be disclosed.⁴⁵ As noted above, FINRA will publish a list of the OTC Equity Security symbols that fall under each category to assist members in generating the reports and provide consistency across reports. FINRA has also provided clarifications regarding the scope of venues that should be disclosed on the reports and the types of fees that should be included.⁴⁶ FINRA will continue to engage with members to provide additional guidance on these and other issues as appropriate.

Third, Fidelity stated that FINRA should explore obtaining data for all, or part, of the proposed OTC Equity Security reports from broker-dealer CAT submissions.⁴⁷

⁴⁴ See supra note 43 at 2-3.

⁴⁵ See supra note 43 at 3-4.

⁴⁶ See supra notes 15 and 17.

⁴⁷ See supra note 43 at 4-5.

FINRA continues to believe that the most efficient and comprehensive means of providing the data included in the OTC Equity Security order routing disclosures is for members to generate the reports directly.

Finally, Fidelity expressed support for FINRA to consolidate all order routing reports on a centralized website and make this content available without cost.⁴⁸ As discussed above, FINRA is proposing to publish both the new OTC Equity Security reports and existing SEC Rule 606(a) reports in a centralized location on its website, free of charge and without usage restrictions.

FIF neither supported nor opposed the proposed rule change but provided comments focused on achieving the most effective implementation in the event that FINRA moves forward with the proposed rule change. FIF first provided its views regarding the entity that should be reported as the “venue” on the reports when there are multiple levels of routing for an order, including the requirement to “look-through” to the execution venue.⁴⁹ FIF stated that, when a customer-facing broker-dealer routes an order to a second broker-dealer, the customer-facing broker-dealer should report on its financial arrangement with the second broker-dealer instead of the fee arrangement between the second broker-dealer and that downstream venue. FIF stated that there are many scenarios where a customer-facing broker-dealer will route an OTC Equity Security order to another broker-dealer that is neither a market maker nor an alternative trading system and therefore the order is further routed by the receiving broker-dealer. In these situations, FIF argued that the customer-facing broker-dealer should report the second

⁴⁸ See supra note 43 at 5.

⁴⁹ See FIF Letter at 1-3.

broker-dealer on any reports instead of the final downstream venue. Reporting the final downstream execution venue, i.e., the “look-through” requirement, would ignore any payment for order flow made by the second broker-dealer to the customer-facing broker. FIF also suggested modifying the proposed rule change such that any reference to “venue” be changed to “venue or broker” and any reference to “routed for execution” be changed to “routed” or “routed for execution or further routing” or “routed for execution (by the recipient or another party).” FIF further stated that the look-through requirement would greatly increase the cost of the report due to the costs associated with coordination between the customer-facing broker-dealer and the second broker-dealer that routes to a venue for execution.⁵⁰

Consistent with the requirements of SEC Rule 606(a), FINRA’s proposal would cover the venues to which non-directed held orders in OTC Equity Securities were “routed for execution.” As discussed above, the SEC has provided guidance in the SEC Rule 606(a) context that, if a broker-dealer routes orders to another broker-dealer, that receiving broker-dealer would be considered to be the relevant venue if that receiving broker-dealer executes orders. However, if the receiving broker-dealer does not execute orders, it would not be a venue to which orders were “routed for execution.” Rather, the venue to which the receiving broker-dealer subsequently routed the orders for execution (including child orders) would be the relevant venues for SEC Rule 606(a) reporting purposes. Further, while the reporting responsibility remains with the customer-facing broker-dealer, the customer-facing broker-dealer may contract with the receiving broker-

⁵⁰ See supra note 49 at 3.

dealer for assistance in meeting its reporting responsibilities.⁵¹ FINRA continues to believe that this aspect of the proposed order routing disclosures for OTC Equity Securities should be consistent with the SEC Rule 606(a) disclosures for NMS Securities, including with respect to the “look-through” requirement when a receiving broker-dealer does not execute orders. FINRA believes that aligning the scope of the disclosures with the requirements of SEC Rule 606(a) would reduce the burden of the new disclosure requirements because members already have experience with SEC Rule 606(a) and may be able to utilize existing systems and arrangements with receiving broker-dealers to provide the disclosures for OTC Equity Securities. Further, because the purpose of the proposed disclosures—providing information about members’ orders routing practices and potential conflicts of interest related to execution venues—is the same as the purpose of SEC Rule 606(a) for NMS Securities, FINRA believes that the same types of venues should be covered by the new reports for OTC Equity Securities.

FIF also responded to a number of specific questions posed in Regulatory Notice 21-35.⁵² As an initial matter, FIF agreed with a number of aspects of the proposed rule change, including (i) the quarterly reporting timeframe of the reports; (ii) not providing a separate reporting category for grey market securities; (iii) limiting the proposed reports to held orders in OTC Equity Securities; (iv) not breaking out the reports by market orders, marketable limit orders, non-marketable limit orders, and other orders; (v) requiring reporting of payments per order, rather than per share; (vi) not adopting

⁵¹ See SEC Division of Trading and Markets, Responses to Frequently Asked Questions Concerning Rule 606 of Regulation NMS, Question 12.01.

⁵² See FIF Letter at 3-9.

customer-specific held order disclosures, like those required under SEC Rule 606(b)(3), at this time; and (vii) not adopting execution quality disclosures, like those required under SEC Rule 605, at this time.

FIF requested that FINRA incorporate a de minimis venue exception parallel to the exemptive relief that the SEC has provided with respect to the SEC Rule 606(a) reports. As noted above, FINRA agrees and has included a parallel exception in the proposed rule change.⁵³

FIF also expressed support for centralized publication of SEC Rule 606(a) reports and, if adopted, the proposed OTC Equity Security reports on the FINRA website (or another third-party website in a manner that can be accessed by all market participants at no cost), and further recommended that the SEC, FINRA, the other self-regulatory organizations and FINRA CAT consider how current reporting systems, such as the CAT, can be leveraged to reduce the general reporting burden for firms. As discussed above, FINRA is proposing to publish both the new OTC Equity Security reports and existing SEC Rule 606(a) reports in a centralized location on its website, free of charge and without usage restrictions. However, FINRA is not proposing to use CAT data for the proposed disclosure requirements in light of restrictions on the use of CAT data and FINRA's continued belief that, as for SEC Rule 606(a) reports, the most efficient method to create and publish the required disclosures is for members to provide the routing information directly.

FIF stated that the proposed categories of OTC Equity Securities are appropriate and recommended that FINRA publish and maintain a file of which symbols are included

⁵³

See supra note 16.

in each category. As noted above, FINRA will publish a list of the OTC Equity Security symbols that fall under each category to assist members in generating the reports and provide consistency across reports.

FIF stated that the proposed disclosures may have unintended consequences, as increased transparency may lead broker-dealers to change how they route held orders in OTC Equity Securities in ways that may be suboptimal for customers on execution quality dimensions that are less easily observable. To address this concern, FIF suggested that FINRA could publish guidance to investors on the purpose, content, and potential limitations of the reports. While FINRA does not believe that the transparency will likely result in suboptimal executions, FINRA intends to, as appropriate, provide members, investors, and others with information about the purpose, content, and potential limitations of the reports.

FIF further stated that the industry requires a significant time period for implementation, including sufficient time for industry members to identify and obtain guidance from FINRA on applicable interpretive questions. FINRA intends to provide an appropriate amount of time for implementation of the proposed rule change and will work with the industry to provide guidance as appropriate on interpretive questions. In particular, FIF requested that FINRA meet with industry members to discuss how the proposed routing disclosures should be applied to orders executed through OTC Link, and also requested that FINRA provide additional guidance on the level of detail required for the material aspects disclosure. FINRA intends to continue to engage with members and other interested parties prior to implementation of the proposed rule change, including to discuss order routing disclosures in scenarios involving OTC Link. FINRA

also intends to provide guidance as appropriate on other interpretive questions, including the content of the material aspects disclosure. However, FINRA notes that it would generally expect the level of detail included in the material aspects disclosures to be consistent with that provided in SEC Rule 606(a) reports for NMS Securities.

FIF generally agreed with the proposed content of the OTC Equity Security disclosure reports, but recommended removing the requirement that members report the number of directed orders because the routing decision in such cases is outside the control of the broker-dealer. FINRA notes that, as described above and consistent with SEC Rule 606(a), the proposed disclosures would apply only to non-directed held orders. The proposed reports would include aggregate statistics regarding the percentage of total orders that were held and not held orders, and the percentage of held orders that were non-directed orders, but no other information about directed orders would be required.

Finally, FIF stated that its members are divided on whether the reporting requirements should include routes to brokers and venues outside the U.S. FIF recommended that multiple approaches should be permitted and that the reporting firm should indicate which approach was adopted on the webpage accompanying the routing reports. In any case, FIF stated that, if a foreign issuer does not have F shares in the U.S., the order should not be reportable. FINRA believes that, consistent with SEC Rule 606(a), the OTC Equity Security disclosures should include information about venues where a member's orders are routed for execution, regardless of the location of such venue. Particularly where orders are non-directed, the member has discretion to choose where it routes orders for execution; therefore, permitting a member to omit foreign venues could raise arbitrage concerns and provide incomplete information to investors.

Moreover, information about incentives and potential conflicts of interest is just as relevant where an execution venue is located abroad. With respect to F shares, FINRA notes that orders in any security that meets the definition of OTC Equity Security would be included in the reports regardless of the location of the issuer.

LPL did not support the proposed rule change, stating that, while LPL supports efforts to provide greater transparency as to the handling of orders, the proposed rule change would impose a significant burden on firms without providing useful information to investors.⁵⁴ LPL stated that the proposed rule change would have limited benefits as compared to SEC Rule 606(a) for NMS Securities, which LPL believes can provide investors with useful information because it can be combined with order execution information available pursuant to SEC Rule 605; by contrast, the proposed OTC Equity Security disclosures would not have parallel execution quality disclosures.⁵⁵

FINRA believes that the proposed order routing disclosures will provide investors and other market participants with useful information, even in the absence of Rule 605-like disclosures at this time.⁵⁶ FINRA believes the proposed order routing disclosures will facilitate investor understanding of where their brokers are routing orders and the relationships their brokers have with those execution venues. In addition, FINRA notes

⁵⁴ See LPL Letter at 1.

⁵⁵ See supra note 54 at 1-2.

⁵⁶ In light of differences between the market for NMS Securities and OTC Equity Securities, including for example the absence of a centralized, SRO-disseminated national best bid and offer in the OTC market, FINRA is not proposing Rule 605-like execution quality disclosure requirements for OTC Equity Securities at this time. FINRA will continue to consider whether additional disclosures would provide useful information for investors in OTC Equity Securities.

that SEC Rule 606(a) includes information about order routing practices for NMS Securities that are options, and options are not included in the execution quality disclosures under SEC Rule 605.

LPL also stated its belief that the proposed rule change would subject firms to costly burdens, including internal technology costs to identify and gather the needed data, vendor costs to prepare quarterly reports, and employee time to implement and supervise disclosures.⁵⁷ Given that OTC Equity Securities are a very small part of LPL's core business, LPL stated that these additional burdens may have a chilling effect and cause firms to stop accepting orders for OTC Equity Securities. As discussed above, FINRA acknowledges that members would incur costs to capture the required data, generate the reports, publish the reports, and transmit the reports to FINRA for centralization publication. FINRA believes that such costs would be reduced for introducing firms that choose to rely on the guidance discussed above.⁵⁸ In any case, FINRA continues to believe that the costs associated with the proposal are outweighed by the benefits to investors and the market of the transparency provided by the proposed OTC Equity Security disclosures.

Finally, LPL stated that imposing the additional costs of the proposed OTC Equity Security disclosures on firms that do not receive payment for order flow would be both unfair and unproductive, and therefore requested that, if FINRA adopts the proposed

⁵⁷ See LPL Letter at 2. LPL stated that it expects the initial costs to implement the proposed rule change would be similar to the cost of complying with recent amendments to SEC Rule 606.

⁵⁸ See supra notes 9 and 24.

rule change, the proposed rule change include an exemption for firms that do not receive payment for order flow.⁵⁹ FINRA notes that, while payment for order flow arrangements are an important component of the information that would be required to be disclosed under the proposed rule change, the proposed disclosures also include information about other payments and arrangements that members may have with execution venues that may influence a member's order routing decision. FINRA continues to believe that the proposed disclosures would be valuable for investors and other market participants more broadly, regardless of whether a particular member receives payment for order flow, because the proposed disclosures would provide investors with a better understanding of where their brokers are routing orders and the overall relationships their brokers have with those execution venues.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.⁶⁰

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

⁵⁹ See LPL Letter at 2-3.

⁶⁰ 15 U.S.C. 78s(b)(2).

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 2a. Regulatory Notice 21-35 (October 2021).

Exhibit 2b. Comments received in response to Regulatory Notice 21-35.

Exhibit 3. Rule 6470 report template.

Exhibit 5. Text of the proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2022-031)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Adopt FINRA Rules 6151 (Disclosure of Order Routing Information for NMS Securities) and 6470 (Disclosure of Order Routing Information for OTC Equity Securities)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt FINRA Rules 6151 (Disclosure of Order Routing Information for NMS Securities) and 6470 (Disclosure of Order Routing Information for OTC Equity Securities) to require members to (i) publish order routing reports for orders in OTC Equity Securities, and (ii) submit their order routing reports for both OTC Equity Securities and NMS Securities to FINRA for publication on the FINRA website.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

The text of the proposed rule change is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Rule 606(a) of Regulation NMS³ (“SEC Rule 606(a)”) requires broker-dealers to publicly disclose specified information about their order routing practices for NMS Securities,⁴ including for non-directed orders in NMS stocks that are submitted on a “held” basis.⁵ The SEC has stated that, as a result of these disclosures, “customers—and

³ 17 CFR 242.606(a).

⁴ Generally, “NMS Securities” include listed stocks and options, and NMS stocks means any NMS Security other than an option. See 17 CFR 242.600(b).

⁵ See Securities Exchange Act Release No. 84528 (November 2, 2018), 83 FR 58338 (November 19, 2018) (Disclosure of Order Handling Information; Final Rule) (“2018 Amendments Release”). The SEC did not specifically define “held” or “not held” orders, but stated that typically 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. See id. at 58340 n.19. As noted by the SEC in the 2018 Amendments Release, broker-dealers utilize the “held” and “not held” order classifications as a matter of industry practice and to comply with regulatory requirements, including audit trail

retail investors in particular—that submit orders to their broker-dealers should be better able to assess the quality of order handling services provided by their broker-dealers and whether their broker-dealers are effectively managing potential conflicts of interest.”⁶

FINRA believes these same goals would be furthered by providing investors with similar order handling information for unlisted stocks, which are not covered by the existing SEC Rule 606(a) disclosure requirements.⁷ Accordingly, FINRA is proposing to adopt new Rule 6470 to require members to publish quarterly order routing disclosures primarily for non-directed held orders in OTC Equity Securities,⁸ generally aligned with the SEC Rule 606(a) disclosures for NMS stocks but with modifications to account for differences between the market for NMS Securities and over-the-counter (“OTC”) markets, as described below. In addition, to make both the existing SEC Rule 606(a) disclosures and the new OTC Equity Security disclosures more accessible to investors, FINRA is proposing new Rule 6151 and paragraph (d) of new Rule 6470 to require

reporting requirements and the definition of “covered order” in Rule 600(b) of Regulation NMS. See id. at 58344.

⁶ See 2018 Amendments Release, 83 FR 58338, 58423.

⁷ FINRA notes that the SEC’s Equity Market Structure Advisory Committee (“EMSAC”) previously recommended enhancing the current order routing disclosures required under SEC Rule 606 with information about OTC Equity Securities, and also expressed support for centralization of the reports. See EMSAC, Recommendations Regarding Modifying Rule 605 and Rule 606 (November 29, 2016), <https://www.sec.gov/spotlight/emsac/emsac-recommendations-rules-605-606.pdf>.

⁸ An “OTC Equity Security” means any equity security that is not an NMS stock, other than a Restricted Equity Security. See FINRA Rule 6420(f). A “Restricted Equity Security” means any equity security that meets the definition of “restricted security” as contained in Securities Act Rule 144(a)(3). See FINRA Rule 6420(k).

members to send both disclosures to FINRA for centralized publication on the FINRA website, as described further below.

Disclosure of Order Routing Information for OTC Equity Securities

Proposed new Rule 6470, entitled “Disclosure of Order Routing Information for OTC Equity Securities,” would require the publication of order routing disclosures for OTC Equity Securities. Specifically, as is already required for broker-dealers with respect to held orders in NMS stocks under SEC Rule 606(a)(1), proposed Rule 6470(a) would require, among other things, every member to make publicly available for each calendar quarter a report on its routing of non-directed orders in OTC Equity Securities that are submitted on a held basis during that quarter, broken down by calendar month, and keep such report posted on an internet website that is free and readily accessible to the public for a period of three years from the initial date of posting on the internet website.⁹ Also in line with the required publication timeframe for NMS stock disclosures under SEC Rule 606(a)(2), proposed Rule 6470(c) would require that a member make the

⁹ Proposed Rule 6470 would apply to “every member,” but FINRA notes that the focus of the proposed disclosures is held orders from customers in OTC Equity Securities, and some members may not engage in any activities involving held orders from customers in OTC Equity Securities. If a member does not accept any orders in OTC Equity Securities from customers during a given calendar quarter (whether held or not held), such member would not be required to publish a report under Rule 6470 for that quarter. Similarly, a member that accepted only not held orders in OTC Equity Securities from customers—but no held orders in OTC Equity Securities from customers—during a given calendar quarter would not be required to publish a report for that quarter. See infra note 21. Further, if a member accepted orders in OTC Equity Securities (whether held, not held, or both) only from other broker-dealers, but not from customers, during a given calendar quarter, such member would not be required to publish a report for that quarter.

new OTC Equity Security report publicly available within one month after the end of the quarter addressed in the report.¹⁰

Under Rule 606(a)(1), the SEC Rule 606(a) reports for NMS Securities are required to be broken out into separate sections for NMS stocks in the S&P 500 Index as of the first day of the quarter, other NMS stocks, and NMS Securities that are options. Since these categories are not relevant to the OTC market, FINRA is proposing to instead require that the new quarterly reports for OTC Equity Securities under Rule 6470(a) be separated into three sections to better reflect the OTC market. Specifically, the new reports would be required to be separated into three sections for: (i) domestic OTC Equity Securities; (ii) American Depositary Receipts (“ADRs”) and foreign ordinaries that are OTC Equity Securities; and (iii) Canadian-listed securities trading in the United States as OTC Equity Securities. To provide for consistency across member reports, FINRA will

¹⁰ FINRA understands that some introducing firms route all of their orders in OTC Equity Securities to one or more clearing firms for further routing to other venues for execution. The SEC has provided guidance that, where an introducing firm routes all of its covered orders to one or more clearing firms for further routing and execution and the clearing firm in fact makes the routing decision, the introducing firm generally may comply with the order routing disclosure requirements by: (i) disclosing its relationship with the clearing firm(s) on its website that includes any payment for order flow received by the introducing firm, and (ii) adopting the clearing firm’s disclosures by reference, provided that the introducing firm has examined the report and does not have reason to believe it materially misrepresents the order routing practices. FINRA intends to provide parallel guidance with respect to proposed Rule 6470. See SEC Division of Trading and Markets, Responses to Frequently Asked Questions Concerning Rule 606 of Regulation NMS, Question 12.01; see also SEC Division of Market Regulation, Staff Legal Bulletin No. 13A, Frequently Asked Questions About Rule 11Ac1-6, Question 4.

publish a list of the OTC Equity Security symbols that fall under each category, and members would be required to publish reports in a manner consistent with such list.¹¹

Under Rule 606(a)(1), the SEC Rule 606(a) reports for NMS Securities must be made available using the most recent versions of the XML schema and associated PDF renderer as published on the SEC's website. Similarly, Rule 6470(a) would specify that the new OTC Equity Security reports must be made available using the most recent versions of the XML schema and associated PDF renderer as published on the FINRA website. FINRA believes this requirement would ensure that reports are generated and published in standardized machine-readable and human-readable forms, which would benefit investors by permitting the public to more easily analyze and compare the OTC Equity Security reports across members, as well as to more easily perform combined analysis of both SEC Rule 606(a) and OTC Equity Security reports.¹²

With respect to the content of the new reports, Rule 6470(a) would require that each section of the new OTC Equity Security reports include the information specified in paragraphs (a)(1) through (4) of proposed Rule 6470, specifically:¹³

¹¹ If the Commission approves the proposed rule change, FINRA will provide information in the Regulatory Notice announcing the effective date regarding where members may access the list of OTC Equity Security symbols that FINRA will maintain on its website.

¹² FINRA would publish the technical specifications for the XML schema and associated PDF renderer on its website for member use in generating the new reports. FINRA expects that, subject to the differences between the SEC Rule 606(a) reports and the OTC Equity Security reports discussed above, the XML schema and associated PDF renderer published by FINRA would be substantially similar to those published by the SEC for the SEC Rule 606(a) reports.

¹³ A template of the proposed new OTC Equity Security report that would be required under proposed Rule 6470 is attached as Exhibit 3.

- the percentage of total orders¹⁴ for the section that were not held orders and held orders, and the percentage of held orders for the section that were non-directed orders;¹⁵
- the identity of the ten venues to which the largest number of total non-directed held orders for the section were routed for execution¹⁶ and of any venue to which

¹⁴ For purposes of proposed Rule 6470(a), “total orders” would include all orders from customers for the section, including both directed and non-directed orders from customers.

¹⁵ For purposes of the proposed disclosures, a “non-directed order” would mean any order from a customer other than a directed order. Consistent with the definition of “directed order” under Regulation NMS, a “directed order” would mean an order from a customer that the customer specifically instructed the member to route to a particular venue for execution. See 17 CFR 242.600(b); see also 2018 Amendments Release, 83 FR 58338, 58339 n.4. FINRA notes that, similar to the definition of “customer” under Rule 600(b)(23) of Regulation NMS, a “customer” is defined under FINRA rules to exclude a broker or dealer. See FINRA Rule 0160(b)(4). Orders from other broker-dealers would therefore be excluded from the proposed disclosures.

¹⁶ Consistent with the SEC’s approach to SEC Rule 606(a), FINRA intends that, for purposes of the proposed disclosures for OTC Equity Securities, a “venue” would be defined broadly to cover any market center or any other person or entity to which a member routes orders for execution. See, e.g., Securities Exchange Act Release No. 43590 (November 17, 2000), 65 FR 75414, 75427 n.63 (December 1, 2000) (Disclosure of Order Execution and Routing Practices) (“The term ‘venue’ is intended to be interpreted broadly to cover ‘market centers’ within the meaning of Rule 11Ac1–5(a)(14) [now Rule 600(b)(46) of Regulation NMS], as well as any other person or entity to which a broker routes non-directed orders for execution. Consequently, the term excludes an entity that is used merely as a vehicle to route an order to a venue selected by the broker-dealer.”); see also 17 CFR 242.600(b)(46) (“Market center means any exchange market maker, OTC market maker, alternative trading system, national securities exchange, or national securities association.”). Accordingly, for purposes of proposed Rule 6470, where an alternative trading system (“ATS”) offers both automatic order execution and order delivery functionality, the ATS should be identified as the venue only when the ATS provides order execution. FINRA believes identification of the ATS in these circumstances is appropriate because the ATS is the venue where the order was routed “for execution,” consistent with SEC guidance for the predecessor to SEC Rule 606. See SEC Division of Market Regulation, Staff Legal Bulletin No. 13A, Frequently Asked Questions About

five percent or more of non-directed held orders for the section were routed for execution, and the percentage of total non-directed held orders for the section routed to the venue;¹⁷

- for each identified venue, the net aggregate amount of any payment for order flow received, payment from any profit-sharing relationship received, transaction fees paid, and transaction rebates received, both as a total dollar amount and per order, for all non-directed held orders for the section; and
- a discussion of the material aspects of the member's relationship with each identified venue, including, without limitation, a description of any arrangement for payment for order flow and any profit-sharing relationship and a description of any terms of such arrangements, written or oral, that may influence a member's order routing decision including, among other things: incentives for equaling or exceeding an agreed upon order flow volume threshold, such as additional payments or a higher rate of payment; disincentives for failing to meet an agreed

Rule 11Ac1-6, Question 12. Conversely, for purposes of proposed Rule 6470, in cases where the ATS instead provides order delivery, the separate market center to which the orders are delivered—e.g., a market maker or other ATS—should be identified as the venue where the order was routed for execution.

¹⁷ However, the proposed rule change would include a de minimis venue exception parallel to exemptive relief that the SEC has provided with respect to the SEC Rule 606(a) reports. See Letter from Annette L. Nazareth, Director, SEC Division of Market Regulation, to Neal E. Sullivan & Gail Marshall-Smith, Bingham Dana LLP (on behalf of First Union Securities, Inc.), dated June 22, 2001, 2001 SEC No-Act. LEXIS 903; see also SEC Division of Market Regulation, Staff Legal Bulletin No. 13A, Frequently Asked Questions About Rule 11Ac1-6, Question 2. Specifically, proposed Rule 6470(b) would provide an exception from the requirement for a member to identify venues that received less than 5% of non-directed held orders for a section, provided that the member has identified the top execution venues that in the aggregate received at least 90% of the member's total non-directed held orders for the section.

upon minimum order flow threshold, such as lower payments or the requirement to pay a fee; volume-based tiered payment schedules; and agreements regarding the minimum amount of order flow that the member would send to a venue.¹⁸

The proposed content of the new OTC Equity Security reports under proposed FINRA Rule 6470(a) generally parallels the content required to be included in SEC Rule 606(a) reports for NMS stocks pursuant to SEC Rule 606(a)(1)(i) through (iv), with the following differences to take into account the different market structure and characteristics of OTC Equity Securities. First, Rule 6470(a)(1) would require members to disclose the percentage of total orders for the section that were not held orders and held orders, in addition to disclosing the percentage of held orders for the section that were non-directed orders.¹⁹ While SEC Rule 606(a) similarly requires broker-dealers to disclose the percentage of orders for each section that were non-directed orders, it does not require broker-dealers to disclose the percentage of total orders for each section that

¹⁸ Similar to SEC Rule 606(a), the types of arrangements referenced above are not an exhaustive list of terms of payment for order flow arrangements or profit-sharing relationships that may influence a broker-dealer's order routing decision that would be required to be disclosed. For example, if a broker-dealer receives a discount on executions in other securities or some other advantage in directing order flow in a specific security to a venue, or if a broker-dealer receives equity rights in a venue in exchange for directing order flow there, then all terms of those arrangements would also be required to be disclosed. Similarly, if a broker-dealer receives variable payments or discounts based on order types and the number of orders sent to a venue, such arrangements would be required to be disclosed. See 2018 Amendments Release, 83 FR 58338, 58376 n.397. However, FINRA notes that these are only examples, and a member would be required to disclose any other material aspects of its relationship with each identified venue regardless of whether a particular example is listed in the proposed rule text or otherwise discussed in this proposed rule change.

¹⁹ See notes 14 and 15 supra.

were not held orders and held orders.²⁰ FINRA believes that requiring members to provide information about the relative amount of a member's held and not held orders in the new reports proposed to be published under Rule 6470(a)(1) would provide investors, regulators, academics, and others seeking to review the reports with additional information regarding the business of brokers active in the OTC market.²¹

Second, the information required to be disclosed under SEC Rule 606(a)(i) through (iii) is required to be broken out into sections for market orders, marketable limit orders, non-marketable limit orders, and other orders. However, FINRA is not adopting these categories for OTC Equity Securities due to the absence of a centralized, self-regulatory organization (SRO)-disseminated national best bid and offer in the OTC market on which to standardize and base marketability. Finally, SEC Rule 606(a)(1)(iii) requires the disclosure of quantitative payment information both as a total dollar amount and per share. In light of different pricing practices in the OTC market, Rule 6470(a)(3)

²⁰ SEC Rule 606(b)(1) provides that customers may request customer-specific information about the handling of both their held and not held orders, and SEC Rule 606(b)(3) provides that customers may request additional customer-specific information about the handling of their not held orders. FINRA is not proposing parallel customer-specific disclosure requirements for OTC Equity Securities at this time.

²¹ The proposed requirement to disclose the percentage of total orders for each section that were not held orders and held orders is the only disclosure requiring any information regarding not held orders, as the remainder of the proposed disclosures apply exclusively to held orders. If a member did not accept any held orders in OTC Equity Securities from customers in a given calendar quarter, it would not be required to publish a report under proposed Rule 6470 for that quarter (even if it accepted orders on a not held basis during that quarter). See note 9, supra.

would instead require the quantitative disclosures for OTC Equity Securities to be expressed as both a total dollar amount and per order (rather than per share).²²

Centralized Hosting of Order Routing Disclosures

As discussed above, SEC Rule 606(a) requires broker-dealers to publish their SEC Rule 606(a) reports for NMS Securities on an internet website that is free and readily accessible for at least three years, and proposed FINRA Rule 6470 would similarly require the new OTC Equity Security reports to be published on a website that is free and readily accessible for at least three years. Currently there is not one location where all SEC Rule 606(a) reports are consolidated, although FINRA understands some broker-dealers use vendors that make their client broker-dealers' reports available through common vendor pages. Thus, regulators, investors and others seeking to review the reports often must locate and obtain the reports from various individual broker-dealer or vendor websites.

To make both the existing Rule 606(a) reports and the new OTC Equity Security reports more accessible for regulators, investors and others seeking to analyze and compare the data, FINRA is proposing to require that members provide the reports to FINRA for central publication on the FINRA website (in addition to posting on a public website for at least three years, as required under Rule 606(a) and proposed Rule

²² For example, FINRA understands that, unlike in the market for NMS Securities where payment for order flow is typically paid as a specified dollar amount per share, payments in the OTC market are predominantly made on a per order basis (with rates typically bucketed by share price category).

6470(a)).²³ Specifically, paragraph (d) of proposed new Rule 6470 would require each member to provide the OTC Equity Security report to FINRA within one month after the end of the quarter addressed in the report in such a manner as may be prescribed by FINRA.²⁴ Proposed new Rule 6151, entitled “Disclosure of Order Routing Information for NMS Securities,” would similarly require each member that is required to publish a report pursuant to SEC Rule 606(a) to provide the report to FINRA, in the manner prescribed by FINRA, within the same time and in the same formats that such report is required to be made publicly available pursuant to SEC Rule 606(a) (*i.e.*, one month after the end of the calendar month addressed in the report). Under both provisions, FINRA would publish such reports on its public website. FINRA will publish both the SEC Rule 606(a) and OTC Equity Security reports in a centralized location on the FINRA website, free of charge and with no restrictions on use of the data.²⁵

²³ FINRA also intends to engage in investor education efforts to help investors and others understand the purpose, content, and potential limitations of the disclosures.

²⁴ FINRA would specify details regarding the manner of submission of the reports to FINRA in a Regulatory Notice or similar publication. Members would be permitted to use a third-party vendor to assist with both the generation of the reports and transmission to FINRA. However, the member would remain responsible for the reports in all respects, including the accuracy of the disclosures and the timeliness and completeness of the submissions to FINRA. Accordingly, a member would be required to submit a corrected report to FINRA (and publish a corrected report on its publicly accessible website) promptly following the discovery of inaccurate data or other error in a previously submitted or posted report.

²⁵ As noted above, the SEC has provided guidance that introducing firms may comply with Rule 606(a) by incorporating their clearing firm(s) reports in specified circumstances, and FINRA intends to provide similar guidance with respect to the OTC Equity Security reports required under proposed Rule 6470. See supra note 10. To facilitate centralized access to the reports, such introducing firms must provide FINRA with a list of their clearing firm(s) and the hyperlink to the webpage where they disclose their clearing firm relationship(s) and adopt the

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice. The effective date will be no later than 365 days following publication of the Regulatory Notice announcing Commission approval of the proposed rule change.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,²⁶ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

FINRA believes that the proposed requirement for members to publish order routing disclosures for OTC Equity Securities, similar to what is available under SEC rules for NMS Securities, would provide valuable information for investors and other market participants, academics, regulators and others regarding order routing practices in the OTC market, thereby enhancing the protection of investors and the public interest. In particular, these new disclosures will enable investors to better assess the quality of their broker-dealers' order handling services for these securities, provide more information on the financial incentives that may affect their broker-dealers' routing decisions, and allow

clearing firm(s)'s reports by reference. Each introducing firm relying on this guidance would be required to provide this information to FINRA upon implementation of the proposed rule change and to update FINRA if the information previously provided changes. This information will enable FINRA to provide investors with relevant information for all firms, including introducing firms incorporating clearing firm reports by reference, on FINRA's website.

²⁶ 15 U.S.C. 78o-3(b)(6).

investors to better evaluate whether their broker-dealers are effectively managing potential conflicts of interest. The proposed requirements for members to send their disclosure reports for both NMS Securities and OTC Equity Securities to FINRA for centralized publication on the FINRA website will make this important information more accessible for regulators, investors, academics and others seeking to analyze and compare the data, particularly across firms, and would facilitate the ability of FINRA and the SEC to review the data for regulatory purposes.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

Economic Impact Assessment

Based on the regulatory need discussed above and summarized below, FINRA has undertaken an economic impact assessment, as set forth below, to analyze the potential economic impacts of the proposed rule change, including potential costs, benefits, and distributional and competitive effects, relative to the current baseline.

Regulatory Need

FINRA believes that in today's markets, where various incentives may impact broker-dealers' order handling decisions, customers have limited access to relevant information to help them assess how their orders are handled, and that different customers may have access to different amounts or categories of relevant information. The proposed requirement for members to publish quarterly order routing disclosures for non-directed held orders in OTC Equity Securities is designed to provide investors with

information to better assess the quality of order handling services provided by their broker-dealers and whether their broker-dealers are effectively managing potential conflicts of interest. In addition, requiring members to send both the existing SEC Rule 606(a) disclosures and the proposed OTC Equity Security disclosures to FINRA for centralized publication on the FINRA website would make these disclosures more accessible to investors and others relevant stakeholders.

Economic Baseline

Between October 1 and December 31, 2020, there were 85, 76, and 55 firms²⁷ quoting domestic OTC Equity Securities, ADRs and foreign ordinaries that are OTC Equity Securities, and Canadian-listed securities trading in the U.S. as OTC Equity Securities, respectively. The average number of symbols quoted per firm in each of these respective security categories was: 496, 681, and 260. Furthermore, the average number of quote events per symbol and firm, 37,831, was the largest for Canadian-listed securities that trade OTC in the U.S. as compared to 1,203 for domestic and 25,105 for ADRs and foreign ordinaries.

There are more firms executing trades than providing quotes in OTC Equity Securities. In the fourth quarter of 2020, there were 261, 250, and 196 firms executing trades in domestic, ADRs and foreign ordinaries, and Canadian-listed securities trading in the U.S. as OTC Equity Securities, respectively. The average number of symbols traded per firm was 287, 491, and 195, and the average number of executions per symbol and per firm was 1,215, 1,082, and 1,381 for these respective security categories. Although

²⁷ A “firm” is any FINRA member that has a Central Registration Depository number.

the average number of executions per symbol per firm was largest for Canadian-listed securities, the average dollar volume per symbol and per firm was largest for the ADRs and foreign ordinaries at \$7,687,626, as compared to \$3,621,871 for domestic and \$2,660,868 for the Canadian-listed securities that trade OTC in the U.S. This reflects the generally lower prices for domestic OTC Equity Securities and Canadian-listed securities that trade OTC in the U.S. as compared to ADRs and foreign ordinary shares.

In the fourth quarter of 2020, there were 560, 573, and 444 firms that routed orders in domestic OTC Equity Securities, ADRs or foreign ordinaries, and Canadian-listed securities that trade as OTC Securities in the U.S, respectively, with approximately 600 unique firms total across the three categories. These numbers represent the potential upper bound on the number of firms by security category that could be required to provide the proposed disclosure reports, as some firms may not handle orders from customers (based on fourth quarter of 2020 data). The average number of symbols routed per firm is 104, 180, and 67, and the average number of orders per symbol and per firm is 170, 124, and 134 for each of the three security categories. Consequently, the largest average number of symbols routed per firm was for ADRs and foreign ordinaries, but the average number of orders per symbol per firm was largest for domestic OTC Equity Securities.

FINRA believes that, at present, customers receive limited information on how members route their orders in OTC Equity Securities, any payments that members receive from execution venues related to the routing of these orders, and the relative order execution quality by member or execution venue. In the absence of regulatory disclosure requirements, any information that customers do receive may be selectively

provided to individual customers and is likely not comparable across firms. Moreover, larger customers may receive more information relative to smaller customers, thereby giving the former an informational advantage. OTC Equity Security routing data is currently not required to be publicly available, and no studies have been conducted on the quality of order handling services provided by firms for such securities.

There are, however, studies that examine the benefits of transparency around the implementation of Rules 605²⁸ and 606 of Regulation NMS with respect to member routing and venue execution quality for NMS stocks. These studies may inform the potential economic impacts from transparency in the market for OTC Equity Securities, although, as noted above, there are significant differences between the market for NMS Securities and OTC Equity Securities. In addition, as Rules 605 and 606 went into effect at approximately the same time, these studies are unable to distinguish the separate effects of order execution quality disclosure under Rule 605 and that of order routing disclosure under Rule 606 on activity in NMS stocks. After implementation of Rule 605, effective and quoted spreads for NYSE-, AMEX-, and NASDAQ-listed stocks declined significantly.²⁹ In addition, the implementation of Rules 605 and 606 resulted in broker-dealers increasingly routing orders in NMS stocks to venues that offered better execution

²⁸ Under Rule 605 (formerly 11Ac1-5), the SEC requires market centers that trade NMS Securities to make monthly electronic reports. These reports include information about each market center's quality of executions on a stock-by-stock basis, including how market orders of different sizes are executed relative to the public quotes. These reports also disclose information about effective spreads and the extent to which executions occur at prices better than the public quotes for marketable orders.

²⁹ See Xin Zhao & Kee H. Chung, Information Disclosure and Market Quality: The Effect of SEC Rule 605 on Trading Costs, 42 The Journal of Financial and Quantitative Analysis, 657-682 (2007).

quality on the dimensions of effective spreads and fill rates, which suggests these reports contain information that appears useful in routing decisions.³⁰

Studies analyzing the market for NMS stocks indicate that broker-dealers may route orders to maximize order flow payments by sending market orders to venues making payments and sending limit orders to venues paying large liquidity rebates. Such routing may not always be in customers' best interests. Make-take fees may lead to agency conflicts and rebate volume pricing tiers may worsen such conflicts further.³¹ Theoretical models of the conflict between investors and their broker-dealers, who may be incentivized to route orders based on the take fees charged or rebates paid by exchanges, find that the conflict of interest reduces investor utility.³² Using Rule 606 data, one study examined broker-dealer routing of non-marketable limit orders in NMS stocks to exchanges offering the largest rebate. This analysis combined with proprietary limit order data found that low-fee (*i.e.*, low-rebate) exchanges fill or fill more rapidly when high-fee (*i.e.*, high-rebate) exchanges do not fill, and non-marketable limit orders earn higher average realized spreads on low-fee than high-fee exchanges.³³

³⁰ See Ekkehart Boehmer, Robert Jennings, & Li Wei, Public Disclosure and Private Decisions: Equity Market Execution Quality and Order Routing, 20 Review of Financial Studies, 315–358 (2007).

³¹ See James J. Angel, Lawrence E. Harris & Chester S. Spatt, Equity Trading in the 21st Century,” 1 Quarterly Journal of Finance, 1–53 (2011); Chester S. Spatt, Is Equity Market Exchange Structure Anti-Competitive? (Dec. 28, 2020) Working Paper.

³² See David A. Cimon, Broker Routing Decisions in Limit Order Markets, 54 Journal of Financial Markets, 1386-4181 (2021).

³³ See Robert Battalio, Shawn A. Corwin & Robert Jennings, Can Brokers Have It All? On the Relation Between Make-Take Fees and Limit Order Execution Quality, 71 The Journal of Finance, 2193–2238 (2016).

In the absence of the proposed disclosures, investors may not know where a broker-dealer routes orders for execution or whether the broker-dealer receives payments or rebates from such venues. In addition, in the absence of order routing and payment for order flow information, customers may not possess information necessary to assist them in forming a preference concerning their brokers' routing choices—particularly where customer commission charges have been reduced or eliminated. Furthermore, if customers have information on how brokers route orders and are able to negotiate commissions to more closely represent the broker-dealer's average execution cost for a particular customer's order flow, then customers may be better able to submit the mix of liquidity-supplying and demanding orders to minimize commissions and improve order execution.³⁴ Even where customers are unable to negotiate fees, agency issues related to order flow payments may be reduced or eliminated if investors know where their orders are routed. As noted above, while these studies examine the benefits of transparency with respect to NMS stocks and there are significant differences between the market for NMS Securities and the market for OTC Equity Securities, these studies may inform analysis of the potential impacts of the proposed disclosure on the OTC market.

Economic Impacts

Anticipated Benefits

Under the proposed rule change, customers would have more information on the financial incentives that may affect their firms' routing decisions, because the reports

³⁴ See Shawn M. O'Donoghue, Transaction Fees: Impact on Institutional Order Types, Commissions, and Execution Quality, 60 Journal of Financial Markets (2022).

would identify the net aggregate amount of any payment for order flow received, payment from any profit-sharing relationship received, transaction fees paid, and transaction rebates received by their firms.

At present, in the absence of order routing reports, customers may be less able to consider indirect costs that may impact execution quality than direct trading costs, such as commissions charged. This is particularly true for retail investors that use the services of zero-commission broker-dealers. Under the proposed rule change, customers may more easily consider indirect and less observable costs, such as transaction fees paid less rebates or payment for order flow, and better assess potential conflicts of interest. Brokerage commissions, if charged, may depend on the amount of payment for order flow received and net make-take fees paid by the firm. For example, members that earn more payment for order flow may pass a portion of this revenue on to customers by offering lower commissions. However, routing solely to maximize rebates or minimize transaction fees may result in lower execution quality than alternative routing strategies and may raise best execution concerns. Without the proposed disclosures, customers may primarily assess the amount of commissions, if charged, when evaluating brokerage service costs. Customers may pay higher net trading costs should zero or lower commission firms offer inferior execution quality. Standardized reports, which would be available on the member's website and centralized on FINRA's website, would allow customers to compare order routing practices across different firms and observe changes in a firm's routing behavior over time. Customers would be able to better compare indirect trading costs and whether payment for order flow received and net transaction fees paid, considering rebates, may be affecting the routing decisions of some firms more

than others or causing changes in routing behavior over time. The information in these reports would permit customers to evaluate firms' routing decisions more effectively and be better informed in making choices among firms. Dividing OTC Equity Securities into separate sections depending on whether they are domestic, ADRs or foreign ordinaries, or Canadian-listed OTC Equity Securities would provide customers with meaningful categories and potentially make the information more useful than if all securities were presented in one group.

FINRA believes that direct benefits to customers stemming from the proposed standardized reports may be limited by a customer's ability to interpret the information in the reports or compare the reports across different members or over time. However, customers may also benefit indirectly through changes in a firm's behavior. A firm may use the standardized reports to compare its order routing to that of competing firms, and subsequently, to improve its order execution quality. Thus, firms that do not route solely based on payment for order flow received, net transaction fees paid (inclusive of rebates), or provide relatively better order execution quality may better compete for customers based on not receiving rebates or providing better order execution quality.³⁵ In addition, academic or industry researchers may analyze the data in the proposed public reports, which will be centralized on FINRA's website, and make their findings describing differences in broker-dealer routing practices public.

Because FINRA members would be required to submit their existing Rule 606(a)

³⁵ In light of differences between the market for NMS Securities and the market for OTC Equity Securities, including for example the absence of a centralized, SRO-disseminated national best bid and offer in the OTC market, FINRA is not proposing execution quality disclosure requirements for OTC Equity Securities at this time.

reports to FINRA for central publication on the FINRA website, investors and academic and other industry researchers may more easily access the SEC Rule 606(a) reports, which should make it easier for users to examine data in SEC Rule 606(a) reports across broker-dealers. The reporting and centralization of both the new OTC Equity Security reports and the existing Rule 606(a) reports should also ease FINRA's access to the reported data for regulatory purposes, thereby reducing FINRA's costs.

Anticipated Costs

Members may incur fixed costs, such as programming, to create the initial proposed reports. These initial costs may vary depending on whether firms collect the data and produce the reports in-house or outsource the process to a third party. Members may pay costs to identify which orders are non-directed and submitted on a held basis and determine the net aggregate amount of any payment for order flow received and net rebates received in total and per order. To the extent that a member already has systems in place to create reports required for NMS Securities under Rule 606(a), which is probable in most cases, then these initial fixed costs may be relatively lower for such members, although the extent to which these costs would be lower for such firms would depend on the degree to which their existing systems for NMS Securities' disclosures may be used for OTC Equity Securities. Once the system to create the proposed reports is built, there would be fixed costs for maintaining the system and on-going compliance costs, and variable costs for creating and posting the publicly available quarterly reports and for transmitting the reports to FINRA.

In addition, firms that route orders in OTC Equity Securities may re-evaluate their best execution evaluation methodologies and, if deemed beneficial, may choose to

incorporate information from the proposed publicly available reports posted by competing firms, which may or may not involve costs to the firm depending on how a firm chooses to use this information.³⁶ Furthermore, as noted by the Commission with respect to new disclosure requirements under Rule 606(b)(3), “[g]iven that broker-dealers will be aware of the metrics to be used a priori, they might route not held orders in a manner that promotes a positive reflection on their respective services but that may be suboptimal for their customers.”³⁷ FINRA notes the same possibility in connection with the proposed rule change requiring the disclosure of OTC order handling disclosures. However, FINRA also notes any such effects would be constrained by a firm’s obligations under FINRA Rule 5310. In addition, to the extent that the proposal increases costs to members, particularly smaller firms, they may attempt to recoup costs by increasing fees for customers or modifying the scope of services offered for OTC Equity Securities.

Further, if firms stop or limit routing orders to venues paying rebates or making payments for order flow given the existence of the proposed reports, then these venues may reduce or eliminate these financial incentives as volumes decline, which could in turn impact the extent to which a market participant is willing to provide liquidity at such venues, potentially resulting in fewer quotes, wider bid-ask spreads, or fewer shares posted at such venues. In addition, the cost of capital for firms that issue OTC Equity

³⁶ While firms that route orders in OTC Equity Securities may re-evaluate their best execution evaluation methodologies and incorporate information from the proposed reports, the proposed new OTC Equity Security order routing disclosure reports themselves would not alter a firm’s best execution obligations.

³⁷ See 2018 Amendments Release, 83 FR 58338, 58425.

Securities may increase if their securities become less liquid. Because members will be responsible for submitting SEC Rule 606(a) reports currently required for NMS

Securities under Regulation NMS to FINRA, they will bear either a direct cost to send the reports to FINRA or an indirect cost if an agent sends the report on their behalf. FINRA believes that introducing firm members that choose to rely on the proposed guidance³⁸ would incur lower costs compared to preparing and providing the actual reports on a quarterly basis on their own or through a third-party vendor.

Alternatives Considered

No other alternatives were considered for the proposed amendments.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The proposed rule change was published for comment in Regulatory Notice 21-35 (October 2021). Five comments were received in response to the Regulatory Notice.³⁹ A copy of the Regulatory Notice is available on FINRA's website at <http://www.finra.org>. Copies of the comment letters received in response to the Regulatory Notice are also available on FINRA's website. The comments are summarized below.

³⁸ See supra notes 10 and 25.

³⁹ See Comment submission from Keith L Hickman, dated October 7, 2021; letter from Howard Meyerson, Managing Director, Financial Information Forum, to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, dated December 2, 2021 ("FIF Letter"); letter from Derrick Chan, Head of Equity Trading and Sales, Fidelity Investments, to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, dated December 6, 2021 ("Fidelity Letter"); letter from Michelle Bryan Oroschakoff, Chief Legal Officer, LPL Financial, to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, dated December 6, 2021 ("LPL Letter"); and letter from Melanie Senter Lubin, President, North American Securities Administrators Association, Inc., to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, dated December 6, 2021 ("NASAA Letter").

NASAA supported the proposed rule change, stating that it is appropriately tailored to reveal potential conflicts of interest and would bring additional transparency to trading practices in the OTC market.⁴⁰ NASAA also expressed support for FINRA's publication of order routing reports on its website, noting that centralization of the reports would allow investors to make comparisons easily, help inform and facilitate regulatory decisions, and help FINRA analyze compliance with the proposed rule, discover best reporting practices to share with its members, perform comparisons to facilitate risk-based examination selections, and determine whether disclosures give rise to the need for investigation.⁴¹ FINRA agrees and, as discussed above, is proposing to publish both the new OTC Equity Security reports and existing SEC Rule 606(a) reports in a centralized location on its website, free of charge and without usage restrictions. Finally, NASAA expressed its belief that investor education is necessary to make the reports useful, and accordingly suggested that FINRA develop and post information for investors on how to read and interpret the data. Alternatively, NASAA suggested that FINRA could develop standard educational materials that firms can either link to or be required to make available with the reports.⁴² FINRA agrees that investor education would be useful and, as noted above, intends to engage in investor education efforts regarding the purpose, content, and potential limitations of the disclosures.⁴³

⁴⁰ See NASAA Letter at 1-3.

⁴¹ See supra note 40 at 3-4.

⁴² See supra note 40 at 5.

⁴³ See supra note 23.

Fidelity also supported the proposed rule change, stating that it largely accomplishes the goals of providing transparency into broker routing and economic practices in OTC Equity Securities, an asset class that has experienced significant growth but remains opaque.⁴⁴ Fidelity also made several recommendations to enhance the effectiveness of the proposed rule change. First, Fidelity recommended that FINRA and the SEC should consider how various order routing disclosure reports, including SEC Rules 605 and 606 reports, are used in the marketplace and could be used together, suggesting that FINRA and the SEC should coordinate their oversight of order routing reports to ensure consistency in process and interpretation.⁴⁵ FINRA agrees with and, as described above, has sought to align the form and content of the new OTC Equity Security reports as closely as possible with the existing Rule 606(a) reports, unless there was a reason for the content to differ due to the unique characteristics of the OTC market. FINRA believes that this approach will assist in ensuring consistency in the process for generating the reports and regulatory interpretation concerning the reporting framework. FINRA also expects to continue its engagement with the SEC regarding order routing and execution quality information more broadly.

Second, Fidelity recommended that FINRA make publicly available a list of OTC Equity Securities appearing in each section of the proposed OTC Equity Security reports, and provide further clarity concerning the definition of market center and fees to be disclosed.⁴⁶ As noted above, FINRA will publish a list of the OTC Equity Security

⁴⁴ See Fidelity Letter at 1-2.

⁴⁵ See supra note 44 at 2-3.

⁴⁶ See supra note 44 at 3-4.

symbols that fall under each category to assist members in generating the reports and provide consistency across reports. FINRA has also provided clarifications regarding the scope of venues that should be disclosed on the reports and the types of fees that should be included.⁴⁷ FINRA will continue to engage with members to provide additional guidance on these and other issues as appropriate.

Third, Fidelity stated that FINRA should explore obtaining data for all, or part, of the proposed OTC Equity Security reports from broker-dealer CAT submissions.⁴⁸ FINRA continues to believe that the most efficient and comprehensive means of providing the data included in the OTC Equity Security order routing disclosures is for members to generate the reports directly.

Finally, Fidelity expressed support for FINRA to consolidate all order routing reports on a centralized website and make this content available without cost.⁴⁹ As discussed above, FINRA is proposing to publish both the new OTC Equity Security reports and existing SEC Rule 606(a) reports in a centralized location on its website, free of charge and without usage restrictions.

FIF neither supported nor opposed the proposed rule change but provided comments focused on achieving the most effective implementation in the event that FINRA moves forward with the proposed rule change. FIF first provided its views regarding the entity that should be reported as the “venue” on the reports when there are multiple levels of routing for an order, including the requirement to “look-through” to the

⁴⁷ See supra notes 16 and 18.

⁴⁸ See supra note 44 at 4-5.

⁴⁹ See supra note 44 at 5.

execution venue.⁵⁰ FIF stated that, when a customer-facing broker-dealer routes an order to a second broker-dealer, the customer-facing broker-dealer should report on its financial arrangement with the second broker-dealer instead of the fee arrangement between the second broker-dealer and that downstream venue. FIF stated that there are many scenarios where a customer-facing broker-dealer will route an OTC Equity Security order to another broker-dealer that is neither a market maker nor an alternative trading system and therefore the order is further routed by the receiving broker-dealer. In these situations, FIF argued that the customer-facing broker-dealer should report the second broker-dealer on any reports instead of the final downstream venue. Reporting the final downstream execution venue, i.e., the “look-through” requirement, would ignore any payment for order flow made by the second broker-dealer to the customer-facing broker. FIF also suggested modifying the proposed rule change such that any reference to “venue” be changed to “venue or broker” and any reference to “routed for execution” be changed to “routed” or “routed for execution or further routing” or “routed for execution (by the recipient or another party).” FIF further stated that the look-through requirement would greatly increase the cost of the report due to the costs associated with coordination between the customer-facing broker-dealer and the second broker-dealer that routes to a venue for execution.⁵¹

Consistent with the requirements of SEC Rule 606(a), FINRA’s proposal would cover the venues to which non-directed held orders in OTC Equity Securities were “routed for execution.” As discussed above, the SEC has provided guidance in the SEC

⁵⁰ See FIF Letter at 1-3.

⁵¹ See supra note 50 at 3.

Rule 606(a) context that, if a broker-dealer routes orders to another broker-dealer, that receiving broker-dealer would be considered to be the relevant venue if that receiving broker-dealer executes orders. However, if the receiving broker-dealer does not execute orders, it would not be a venue to which orders were “routed for execution.” Rather, the venue to which the receiving broker-dealer subsequently routed the orders for execution (including child orders) would be the relevant venues for SEC Rule 606(a) reporting purposes. Further, while the reporting responsibility remains with the customer-facing broker-dealer, the customer-facing broker-dealer may contract with the receiving broker-dealer for assistance in meeting its reporting responsibilities.⁵² FINRA continues to believe that this aspect of the proposed order routing disclosures for OTC Equity Securities should be consistent with the SEC Rule 606(a) disclosures for NMS Securities, including with respect to the “look-through” requirement when a receiving broker-dealer does not execute orders. FINRA believes that aligning the scope of the disclosures with the requirements of SEC Rule 606(a) would reduce the burden of the new disclosure requirements because members already have experience with SEC Rule 606(a) and may be able to utilize existing systems and arrangements with receiving broker-dealers to provide the disclosures for OTC Equity Securities. Further, because the purpose of the proposed disclosures—providing information about members’ orders routing practices and potential conflicts of interest related to execution venues—is the same as the purpose of SEC Rule 606(a) for NMS Securities, FINRA believes that the same types of venues should be covered by the new reports for OTC Equity Securities.

⁵² See SEC Division of Trading and Markets, Responses to Frequently Asked Questions Concerning Rule 606 of Regulation NMS, Question 12.01.

FIF also responded to a number of specific questions posed in Regulatory Notice 21-35.⁵³ As an initial matter, FIF agreed with a number of aspects of the proposed rule change, including (i) the quarterly reporting timeframe of the reports; (ii) not providing a separate reporting category for grey market securities; (iii) limiting the proposed reports to held orders in OTC Equity Securities; (iv) not breaking out the reports by market orders, marketable limit orders, non-marketable limit orders, and other orders; (v) requiring reporting of payments per order, rather than per share; (vi) not adopting customer-specific held order disclosures, like those required under SEC Rule 606(b)(3), at this time; and (vii) not adopting execution quality disclosures, like those required under SEC Rule 605, at this time.

FIF requested that FINRA incorporate a de minimis venue exception parallel to the exemptive relief that the SEC has provided with respect to the SEC Rule 606(a) reports. As noted above, FINRA agrees and has included a parallel exception in the proposed rule change.⁵⁴

FIF also expressed support for centralized publication of SEC Rule 606(a) reports and, if adopted, the proposed OTC Equity Security reports on the FINRA website (or another third-party website in a manner that can be accessed by all market participants at no cost), and further recommended that the SEC, FINRA, the other self-regulatory organizations and FINRA CAT consider how current reporting systems, such as the CAT, can be leveraged to reduce the general reporting burden for firms. As discussed above, FINRA is proposing to publish both the new OTC Equity Security reports and existing

⁵³ See FIF Letter at 3-9.

⁵⁴ See supra note 17.

SEC Rule 606(a) reports in a centralized location on its website, free of charge and without usage restrictions. However, FINRA is not proposing to use CAT data for the proposed disclosure requirements in light of restrictions on the use of CAT data and FINRA's continued belief that, as for SEC Rule 606(a) reports, the most efficient method to create and publish the required disclosures is for members to provide the routing information directly.

FIF stated that the proposed categories of OTC Equity Securities are appropriate and recommended that FINRA publish and maintain a file of which symbols are included in each category. As noted above, FINRA will publish a list of the OTC Equity Security symbols that fall under each category to assist members in generating the reports and provide consistency across reports.

FIF stated that the proposed disclosures may have unintended consequences, as increased transparency may lead broker-dealers to change how they route held orders in OTC Equity Securities in ways that may be suboptimal for customers on execution quality dimensions that are less easily observable. To address this concern, FIF suggested that FINRA could publish guidance to investors on the purpose, content, and potential limitations of the reports. While FINRA does not believe that the transparency will likely result in suboptimal executions, FINRA intends to, as appropriate, provide members, investors, and others with information about the purpose, content, and potential limitations of the reports.

FIF further stated that the industry requires a significant time period for implementation, including sufficient time for industry members to identify and obtain guidance from FINRA on applicable interpretive questions. FINRA intends to provide an

appropriate amount of time for implementation of the proposed rule change and will work with the industry to provide guidance as appropriate on interpretive questions. In particular, FIF requested that FINRA meet with industry members to discuss how the proposed routing disclosures should be applied to orders executed through OTC Link, and also requested that FINRA provide additional guidance on the level of detail required for the material aspects disclosure. FINRA intends to continue to engage with members and other interested parties prior to implementation of the proposed rule change, including to discuss order routing disclosures in scenarios involving OTC Link. FINRA also intends to provide guidance as appropriate on other interpretive questions, including the content of the material aspects disclosure. However, FINRA notes that it would generally expect the level of detail included in the material aspects disclosures to be consistent with that provided in SEC Rule 606(a) reports for NMS Securities.

FIF generally agreed with the proposed content of the OTC Equity Security disclosure reports, but recommended removing the requirement that members report the number of directed orders because the routing decision in such cases is outside the control of the broker-dealer. FINRA notes that, as described above and consistent with SEC Rule 606(a), the proposed disclosures would apply only to non-directed held orders. The proposed reports would include aggregate statistics regarding the percentage of total orders that were held and not held orders, and the percentage of held orders that were non-directed orders, but no other information about directed orders would be required.

Finally, FIF stated that its members are divided on whether the reporting requirements should include routes to brokers and venues outside the U.S. FIF recommended that multiple approaches should be permitted and that the reporting firm

should indicate which approach was adopted on the webpage accompanying the routing reports. In any case, FIF stated that, if a foreign issuer does not have F shares in the U.S., the order should not be reportable. FINRA believes that, consistent with SEC Rule 606(a), the OTC Equity Security disclosures should include information about venues where a member's orders are routed for execution, regardless of the location of such venue. Particularly where orders are non-directed, the member has discretion to choose where it routes orders for execution; therefore, permitting a member to omit foreign venues could raise arbitrage concerns and provide incomplete information to investors. Moreover, information about incentives and potential conflicts of interest is just as relevant where an execution venue is located abroad. With respect to F shares, FINRA notes that orders in any security that meets the definition of OTC Equity Security would be included in the reports regardless of the location of the issuer.

LPL did not support the proposed rule change, stating that, while LPL supports efforts to provide greater transparency as to the handling of orders, the proposed rule change would impose a significant burden on firms without providing useful information to investors.⁵⁵ LPL stated that the proposed rule change would have limited benefits as compared to SEC Rule 606(a) for NMS Securities, which LPL believes can provide investors with useful information because it can be combined with order execution information available pursuant to SEC Rule 605; by contrast, the proposed OTC Equity Security disclosures would not have parallel execution quality disclosures.⁵⁶

⁵⁵ See LPL Letter at 1.

⁵⁶ See supra note 55 at 1-2.

FINRA believes that the proposed order routing disclosures will provide investors and other market participants with useful information, even in the absence of Rule 605-like disclosures at this time.⁵⁷ FINRA believes the proposed order routing disclosures will facilitate investor understanding of where their brokers are routing orders and the relationships their brokers have with those execution venues. In addition, FINRA notes that SEC Rule 606(a) includes information about order routing practices for NMS Securities that are options, and options are not included in the execution quality disclosures under SEC Rule 605.

LPL also stated its belief that the proposed rule change would subject firms to costly burdens, including internal technology costs to identify and gather the needed data, vendor costs to prepare quarterly reports, and employee time to implement and supervise disclosures.⁵⁸ Given that OTC Equity Securities are a very small part of LPL's core business, LPL stated that these additional burdens may have a chilling effect and cause firms to stop accepting orders for OTC Equity Securities. As discussed above, FINRA acknowledges that members would incur costs to capture the required data, generate the reports, publish the reports, and transmit the reports to FINRA for centralization publication. FINRA believes that such costs would be reduced for introducing firms that

⁵⁷ In light of differences between the market for NMS Securities and OTC Equity Securities, including for example the absence of a centralized, SRO-disseminated national best bid and offer in the OTC market, FINRA is not proposing Rule 605-like execution quality disclosure requirements for OTC Equity Securities at this time. FINRA will continue to consider whether additional disclosures would provide useful information for investors in OTC Equity Securities.

⁵⁸ See LPL Letter at 2. LPL stated that it expects the initial costs to implement the proposed rule change would be similar to the cost of complying with recent amendments to SEC Rule 606.

choose to rely on the guidance discussed above.⁵⁹ In any case, FINRA continues to believe that the costs associated with the proposal are outweighed by the benefits to investors and the market of the transparency provided by the proposed OTC Equity Security disclosures.

Finally, LPL stated that imposing the additional costs of the proposed OTC Equity Security disclosures on firms that do not receive payment for order flow would be both unfair and unproductive, and therefore requested that, if FINRA adopts the proposed rule change, the proposed rule change include an exemption for firms that do not receive payment for order flow.⁶⁰ FINRA notes that, while payment for order flow arrangements are an important component of the information that would be required to be disclosed under the proposed rule change, the proposed disclosures also include information about other payments and arrangements that members may have with execution venues that may influence a member's order routing decision. FINRA continues to believe that the proposed disclosures would be valuable for investors and other market participants more broadly, regardless of whether a particular member receives payment for order flow, because the proposed disclosures would provide investors with a better understanding of where their brokers are routing orders and the overall relationships their brokers have with those execution venues.

⁵⁹ See supra notes 10 and 25.

⁶⁰ See LPL Letter at 2-3.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2022-031 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2022-031. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The

Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2022-031 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁶¹

Jill M. Peterson
Assistant Secretary

⁶¹ 17 CFR 200.30-3(a)(12).

Exhibit 2a

Regulatory Notice

21-35

Order Routing Disclosures for OTC Equity Securities

FINRA Requests Comment on Proposed Order Routing Disclosure Requirements for OTC Equity Securities and Potential Steps to Facilitate Investor Access to Current Order Routing Disclosures for NMS Securities

Comment Period Expires: December 6, 2021

Summary

FINRA requests comment on a proposal to require members to publish quarterly order routing disclosure reports for held orders in OTC Equity Securities. The proposed new quarterly reports would be similar to those required for NMS stocks under the Securities and Exchange Commission's (SEC) Rule 606(a) of Regulation NMS, with certain modifications reflecting the different structure of the OTC market. FINRA also requests input on possible steps to further facilitate investor access and understanding of current order routing disclosures for NMS securities.

Questions regarding this *Notice* should be directed to:

- ▶ Scott Trilling, Senior Director, Market Regulation (MR), at (240) 386-5113 or scott.trilling@finra.org;
- ▶ Susan Lee, Special Counsel, MR, at (240) 386-5054 or susan.lee@finra.org; or
- ▶ Robert McNamee, Associate General Counsel, Office of General Counsel, at (202) 728-8012 or robert.mcnamee@finra.org.

Questions regarding the Economic Impact Assessment in this *Notice* should be directed to Shawn O'Donoghue, Economist, Office of the Chief Economist, at (202) 728-8273 or shawn.odonoghue@finra.org.

October 6, 2021

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Senior Management
- ▶ Systems
- ▶ Trading

Key Topics

- ▶ Disclosure of Order Routing
- ▶ NMS Securities
- ▶ Order Handling
- ▶ OTC Equity Securities
- ▶ Payment for Order Flow

Referenced Rules

- ▶ Exchange Act Rule 600
- ▶ Exchange Act Rule 605
- ▶ Exchange Act Rule 606
- ▶ FINRA Rule 6420
- ▶ FINRA Rule 6434
- ▶ FINRA Rule 6437
- ▶ FINRA Rule 6450
- ▶ FINRA Rule 6460

Action Requested

FINRA encourages all interested parties to comment on this proposal. Comments must be received by December 6, 2021.

Comments must be submitted through one of the following methods:

- ▶ Online using FINRA's comment form for this *Notice*;
- ▶ Emailing comments to pubcom@finra.org; or
- ▶ Mailing comments in hard copy to:

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

To help FINRA process and review comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: Comments received in response to *Regulatory Notices* will be made available to the public on the FINRA website. In general, comments will be posted as they are received.¹

Before becoming effective, the proposed rule change must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA or Exchange Act).²

Background and Discussion

Beginning in 2010, FINRA incorporated the principles of several rules from Regulation NMS into the regulatory framework for OTC Equity Securities.³ Specifically, FINRA adopted "NMS-Principled Rules" that govern four areas of quotation practices for OTC Equity Securities: minimum pricing increments, locking and crossing quotations, access fees and limit order display.⁴ The purpose of the NMS-Principled Rules was to enhance market quality and to better protect investors in unlisted stocks. Since that time, FINRA has continued to review Regulation NMS to determine if it would be beneficial to apply other aspects of Regulation NMS to OTC Equity Securities.

Rule 606 of Regulation NMS requires broker-dealers to disclose certain information about their order routing practices for NMS securities.⁵ In 2018, the SEC adopted amendments to Rule 606 that, among other things, enhanced the content and modified the scope of quarterly public order routing reports for "held" orders in NMS securities under Rule 606(a).⁶ The intent of the updated order routing disclosure requirements under Rule 606(a)

is that “customers—and retail investors in particular—that submit orders to their broker-dealers should be better able to assess the quality of order handling services provided by their broker-dealers and whether their broker-dealers are effectively managing potential conflicts of interest.”⁷ Importantly, the SEC noted that such additional transparency enhances competition for order flow between broker-dealers, which may result in improved execution quality and lower transaction costs for customers.⁸

FINRA believes these same goals would be furthered by applying certain aspects of Rule 606, as amended, to orders in OTC Equity Securities.⁹ In particular, FINRA believes that public disclosure of order routing practices and arrangements, including payment for order flow, would enhance competition and benefit customers who participate in the markets for OTC Equity Securities. Accordingly, and based on initial discussions and feedback from FINRA committees, FINRA is considering a proposal to adopt new requirements for public quarterly order routing reports for held orders in OTC Equity Securities. These new reports would be similar to the reports required for NMS securities under Rule 606(a), but tailored to reflect differences between the markets for NMS securities and OTC Equity Securities.

Scope and Format of Proposed Disclosures

Under the proposal, each member would be required to make publicly available for each calendar quarter a report on its routing of non-directed orders¹⁰ in OTC Equity Securities that are submitted on a held basis.¹¹ Such reports would be required to be broken down by calendar month and made publicly available within one month after the end of the quarter addressed in the report. The reports would be required to be posted on a website that is free and readily accessible to the public for three years, and would be required to be made available in a standardized format to be determined by FINRA.¹² These proposed format and timing requirements are in line with the reports required for NMS securities under Rule 606(a). A proposed sample of the report’s format is provided in **Attachment A**.

FINRA is proposing that the new quarterly reports for OTC Equity Securities be separated into sections for: (i) domestic OTC Equity Securities; (ii) American Depositary Receipts (ADRs) and foreign ordinaries that are OTC Equity Securities; and (iii) Canadian-listed securities trading in the United States as OTC Equity Securities.¹³ FINRA understands that in many instances broker-dealers currently segment securities into these categories for purposes of their internal assessments of routing and execution quality and other operational processes. FINRA therefore believes that breaking out the reports in this manner would be consistent with current OTC market practice and thereby make the reports more useful for consumers of the data.¹⁴

Content of Proposed Disclosures

With respect to the content of the quarterly public reports within each of the three security-type sections noted above, FINRA is proposing disclosures similar to those required under Rule 606(a) for NMS stocks, but simplified to provide more targeted information relevant to the market for OTC Equity Securities. Specifically, for each of the three categories of OTC Equity Securities noted above, the new quarterly reports would require the following disclosures:

- i. the percentage of total orders that were non-directed orders;¹⁵
- ii. the identity of the 10 venues to which the largest number of total non-directed orders were routed for execution and of any venue to which five percent or more of non-directed orders were routed for execution, and the percentage of total non-directed orders routed to the venue;¹⁶
- iii. for each venue identified under (ii) above, the net aggregate amount of any payment for order flow received, payment from any profit-sharing relationship received, transaction fees paid, and transaction rebates received, both as a total dollar amount and per order;¹⁷ and
- iv. a discussion of the material aspects of the member's relationship with each venue identified under (ii) above, including a description of any arrangement for payment for order flow and any profit-sharing relationship and a description of any terms of such arrangements, written or oral, that may influence a member's order routing decision including, among other things:
 - (A) incentives for equaling or exceeding an agreed upon order flow volume threshold, such as additional payments or a higher rate of payment;
 - (B) disincentives for failing to meet an agreed upon minimum order flow threshold, such as lower payments or the requirement to pay a fee;
 - (C) volume-based tiered payment schedules; and
 - (D) agreements regarding the minimum amount of order flow that the member would send to a venue.¹⁸

FINRA preliminarily believes that these targeted public disclosures, tailored to the unique characteristics of OTC Equity Securities, would represent an important first step toward increasing transparency around order routing practices in the OTC market. FINRA notes that it continues to consider whether other types of disclosures under Regulation NMS may also be appropriate to apply to OTC Equity Securities, including customer-specific disclosures concerning handling of "not held" orders under Rule 606(b)(3) and execution quality disclosures under Rule 605. While FINRA believes such disclosures could potentially be beneficial for OTC Equity Securities, FINRA is taking an incremental approach to applying order routing and execution quality disclosures to OTC Equity Securities and is not proposing such requirements at this time.

Potential Additional Steps to Enhance Investor Access to Current Order Routing Disclosures for NMS Securities

FINRA is also interested in public feedback on any steps FINRA could take to facilitate investor access to, and understanding of, the existing order handling disclosures for NMS securities required by Rule 606(a). FINRA believes that the new Rule 606(a) disclosures have provided valuable information to the public that was not previously available, in particular about payment for order flow arrangements.

Currently, Rule 606(a) requires every broker or dealer to make these disclosures available on free and publicly available websites. When the SEC adopted the amended Rule 606(a) disclosure requirements in 2018, it acknowledged that consolidating Rule 606(a) reports in a central location could facilitate its ultimate goal of enabling customers to more readily and meaningfully assess broker-dealers' order handling practices.¹⁹ Given the importance of the Rule 606(a) reports, FINRA would welcome input on the questions posed below about steps FINRA could take to complement the SEC's goals by facilitating investors' ability to access and understand the reports.

Economic Impact Assessment

FINRA has undertaken a preliminary economic impact assessment, as set forth below, to analyze the potential economic impacts of the proposal, including potential costs, benefits and distributional and competitive effects relative to the current baseline. FINRA invites comments on all aspects of this assessment and requests that commenters provide empirical data or other factual support wherever possible.

Regulatory Need

Since 2010, FINRA has integrated principles from Regulation NMS into the regulatory framework for OTC Equity Securities. The objective of these NMS-Principled Rules is to enhance market quality and better protect investors in unlisted stocks. In 2018, the SEC amended Rule 606 of Regulation NMS to enhance the content of, and modify the scope of, the public standardized reports that a broker-dealer must publish concerning the broker-dealer's handling of customers' held orders. These enhanced disclosures give customers and the public information about the average rebate broker-dealers received from, and fees broker-dealers paid to, trading venues, among other things. The purpose of these disclosures is to assist investors in better understanding how broker-dealers route their orders and the impact of this routing on order execution quality.

FINRA believes the principles embodied in Rule 606 of Regulation NMS can be tailored to apply to OTC Equity Securities. Specifically, FINRA believes public disclosure of order routing practices and arrangements, including payment for order flow, would provide better and more actionable information to customers and therefore enhance competition among

broker-dealers and benefit retail customers who trade OTC Equity Securities. Consequently, FINRA is considering proposing new requirements for public quarterly order routing reports for held orders in OTC Equity Securities. These new reports would be like the reports required for NMS securities under Rule 606(a) but tailored to reflect differences between the markets for NMS securities and OTC Equity Securities.

Economic Baseline

Between October 1 and December 31, 2020, there were 85, 76 and 55 broker-dealer firms²⁰ offering quotations in domestic OTC Equity Securities, ADRs and foreign ordinaries that are OTC Equity Securities, and Canadian-listed securities trading in the U.S. as OTC Equity Securities. The average number of symbols quoted per firm in each of these respective security categories was: 496, 681 and 260. Furthermore, the average number of quotes per symbol and per firm, 37,831, was the largest for Canadian-listed securities that trade OTC in the U.S., as compared to 1,203 for domestic and 25,105 for ADRs and foreign ordinaries.

There are more firms executing trades than providing quotes in OTC Equities Securities. In the fourth quarter of 2020, there were 261, 250 and 196 firms executing trades in domestic, ADRs and foreign ordinaries, and Canadian-listed securities trading in the U.S. as OTC Equity Securities. The average number of symbols traded per firm was 287, 491 and 195; and the average number of trades per symbol and per firm was 1,215, 1,082 and 1,381 for these respective security categories. Although the average number of executions per symbol per firm was largest for domestic securities, the average dollar volume per symbol and per firm was largest for the ADRs and foreign ordinaries at \$7,687,626, as compared to \$3,621,871 for domestic and \$2,660,868 for the Canadian-listed securities that trade OTC in the U.S. This reflects the generally lower prices for domestic OTC equities and Canadian-listed securities that trade OTC in the U.S. than for ADRs and foreign ordinary shares.

In the fourth quarter of 2020, there were 560, 573 and 444 firms that routed orders for domestic OTC Equity Securities, ADRs or foreign ordinaries that are OTC Equity Securities, and Canadian-listed securities that trade as OTC Securities in the U.S., respectively. These numbers represent the potential upper bound on the maximum possible number of firms by security category that could be required to provide the proposed disclosure reports, as some firms may not handle customer orders (based on fourth quarter of 2020 data). The average number of symbols routed per firm is 104, 180 and 67—and the average number of orders per symbol and per firm is 170, 124 and 134 for each of the three security categories. Consequently, the largest average number of symbols routed per firm was for ADRs and foreign ordinaries, but the average number of orders per symbol per firm was largest for domestic OTC Equity Securities.

FINRA believes that, at present, customers receive limited information on how members route their orders in OTC Equity Securities, any payments that members receive from execution venues related to the routing of these orders and the relative order execution quality by member or execution venue. In the absence of regulatory disclosure

requirements, any information that customers do receive may be selectively provided to individual customers and is likely not comparable across broker-dealers. Moreover, larger customers may receive more information relative to smaller customers, thereby giving the former an informational advantage. OTC Equity Security routing data is currently not required to be publicly available and no studies have been conducted on the quality of order handling services provided by broker-dealers for such securities.

There are, however, studies that examine the benefits of transparency around the implementation of Rules 605²¹ and 606 of Regulation NMS with respect to member routing and venue execution quality for NMS stocks. These studies may inform the potential economic impacts from transparency in the OTC market although, as noted above, there are significant differences between the OTC and listed markets. In addition, as Rules 605 and 606 went into effect at approximately the same time, these studies are unable to distinguish between the separate effects of order execution quality disclosure under Rule 605 and that of order routing disclosure under Rule 606 on the routing of orders in NMS stocks. After implementation of Rule 605, effective and quoted spreads for NYSE-, AMEX-, and NASDAQ-listed stocks declined significantly.²² In addition, the implementation of Rules 605 and 606 resulted in broker-dealers increasingly routing orders in NMS stocks to venues that offered better execution quality on the dimensions of effective spreads and fill rates, which suggests these reports contain information that appears useful in routing decisions.²³

Studies analyzing the market for NMS stocks indicate that broker-dealers may route orders to maximize order flow payments by sending market orders to venues making such payments and sending limit orders to venues paying large liquidity rebates. Such routing may not always be in customers' best interests. Make-take fees may lead to such agency conflicts and rebate volume pricing tiers may worsen such conflicts further.^{24,25} Theoretical models of the conflict between investors and their broker-dealers, who have an incentive to route orders based on the take fees paid or rebates charged by exchanges, find that the conflict of interest reduces investor utility.²⁶ Using Rule 606 data, one study examined broker-dealer routing of non-marketable limit orders in NMS stocks to exchanges offering the largest rebate. This analysis combined with proprietary limit order data found that low-fee (*i.e.*, low-rebate) exchanges fill or fill more rapidly when high-fee (*i.e.*, high-rebate) exchanges do not fill, and non-marketable limit orders earn higher average realized spreads on low-fee than high-fee exchanges.²⁷

If commissions paid by investors are conditioned on the fees paid and rebates received by broker-dealers, then investors may be indifferent to which type of exchange broker-dealers route orders. In a study using NMS stock trade data from a single large institutional investor with a trading style that avoids demanding immediacy, net (of fees and rebates) realized spreads do not differ between exchanges.²⁸ Furthermore, if commissions are negotiated such that they represent the broker-dealer's average execution cost, investors may submit a mix of liquidity-supplying and demanding orders to minimize commissions

and improve order execution.²⁹ Therefore, agency issues related to order flow payments can be reduced or eliminated if investors know where their orders are routed and can negotiate commissions conditioned on the payments that broker-dealers receive. As noted above, while these studies examine the benefits of transparency with respect to NMS stocks and there are significant differences between the OTC and listed markets, these studies may inform analysis of the potential impacts from transparency in the OTC market.

Potential Economic Impacts

Potential Benefits

Under this proposal, each broker-dealer that routes non-directed orders in OTC Equity Securities on a held basis would be required to make publicly available quarterly routing reports organized by month. As these reports would provide the percentage of total orders that were non-directed and the identity of the 10 venues to which the largest number of total non-directed orders were routed for execution, customers would be better able to understand which venue likely executed their OTC Equity Security orders. Given that these reports would also identify the net aggregate amount of payment for order flow, other payments from profit-sharing, and transaction fees paid and rebates received by their broker-dealer, customers would have more information on the financial incentives that affect their broker-dealer's routing decisions.

At present, customers may only be aware of direct trading costs, such as any commission charged. Should this proposal be adopted, customers may more easily consider indirect and less observable costs, such as transaction fees paid less rebates or payment for order flow. Brokerage commissions, if charged, may depend on the amount of payment for order flow received and net make-take fees paid by the broker-dealer. For example, broker-dealers that earn more payment for order flow may pass a portion of this revenue on to customers by offering lower commissions. However, routing solely to maximize rebates or minimize transaction fees may result in lower execution quality than alternative routing strategies. Without the proposed disclosures, customers are only able to consider the magnitude of commissions, if charged, when evaluating brokerage service costs. Such customers could, in fact, end up paying higher net trading costs should zero or lower commission broker-dealers offer inferior execution quality. Standardized reports would allow customers to compare order routing practices across different broker-dealers and observe changes in a broker-dealer's routing behavior over time. Customers would be able to better compare indirect trading costs and whether payment for order flow received and net transaction fees paid, considering rebates, is affecting the routing decisions of some broker-dealers more than others or causing changes in routing behavior over time. The information in these reports would permit customers to evaluate broker-dealer routing decisions more effectively and be better informed in making choices among broker-dealers.

In addition, under the proposal, OTC Equity Securities would be grouped into the following categories: (i) domestic OTC Equity Securities; (ii) ADRs and foreign ordinaries that are OTC Equity Securities; and (iii) Canadian-listed securities trading in the U.S. as OTC Equity Securities. This categorization would provide customers with more granular information regarding broker-dealer routing and payment for order flow received and net transaction fees paid than if OTC Equity Securities were combined into one group.

The potential direct benefits to customers of the proposed standardized reports may be limited by a customer's ability to interpret the information in the reports or compare the reports across different broker-dealers or over time. However, customers may also benefit indirectly through changes in broker-dealer behavior. A broker-dealer may use the standardized reports to compare its order routing to that of competing broker-dealers, and subsequently, to improve its order execution quality. Thus, broker-dealers that do not route solely based on payment for order flow received, net transaction fees paid (inclusive of rebates), or provide relatively better order execution quality, may better compete for customers based on not receiving rebates or providing better order execution quality. In addition, academic or industry researchers may analyze the data in the proposed public reports and make their findings describing differences in broker-dealer routing practices public.

Potential Costs

Broker-dealers may incur fixed costs, such as programming, to create the initial proposed reports. These initial costs may vary depending on whether broker-dealers collect the data and produce the reports in-house or outsource the process to a third party. In particular, broker-dealers may pay costs to: identify which orders are non-directed and submitted on a held basis; differentiate between domestic OTC Equity Securities, ADRs and foreign ordinaries that are OTC Equity Securities, and Canadian-listed securities that trade in the U.S. as OTC Equity Securities; and determine the net aggregate amount of any payment for order flow received and net rebates received in total and per order. To the extent that a broker-dealer already has systems in place to create reports required for NMS securities under Rule 606(a), then these initial fixed costs may be relatively lower for such broker-dealers, although the extent to which these costs would be lower for such firms would depend on the degree to which their existing systems for NMS securities may be used for OTC Equity Securities. Once the system to create the proposed reports is built, there would be fixed costs for maintaining the system and on-going compliance costs, and variable costs for creating and posting the publicly available quarterly reports.

In addition, broker-dealers that route OTC Equity Securities orders may re-evaluate their best execution evaluation methodologies and incorporate information from the proposed publicly available reports posted by competing broker-dealers. This may impose a cost only to the extent a broker-dealer chooses to use this information when routing orders or re-evaluating their best execution obligations. This would likely occur only in those

circumstances that the broker-dealer anticipated a positive economic impact from the activity. Furthermore, greater transparency around routing practices may lead broker-dealers to change how they route held orders in NMS stocks in a way that reflects positively on their routing decisions but could be suboptimal for their customers on other dimensions. Similar effects could apply to the routing of held orders in OTC Equity Securities due to the proposed disclosure reports. Therefore, customer orders could experience worse execution quality, particularly on dimensions that are less easily observable or measured by customers (*e.g.*, wider bid-ask spreads, smaller realized spreads, lower fill rates, slower execution or more adverse selection).

Finally, if broker-dealers stop or limit routing orders to venues paying rebates or making payments for order flow, given the existence of the proposed reports, then these venues may reduce or eliminate these financial incentives as their volume declines. In the absence of these rebates or payment for order flow, overall competition among liquidity providers could decline, reducing the liquidity available. Consequently, fewer quotes may be posted, bid-ask spreads may widen or the number of shares at the posted quotes may decline. In such an event, customers may pay a larger half spread, experience more adverse selection, or their orders may receive fills less frequently or with a longer delay. In addition, the cost of capital for firms that issue OTC Equity Securities may increase if their securities become less liquid.

Request for Comment

FINRA requests comment on all aspects of the proposal. FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible. In addition to general comments, FINRA specifically requests comments on the following questions:

1. Would the proposed order routing disclosure reports provide useful information to the marketplace? Why or why not? If the proposed reports would provide benefits, which market participants would find the disclosures useful? Would certain market participants benefit more than others? If so, why?
2. What costs would be associated with the proposed disclosure reports? Please be specific.
 - a. What costs would be incurred by members to produce the new reports?
 - b. What operational or other challenges would be associated with implementing the proposal?
 - c. Would the proposed disclosures lead to other costs or harms to market participants? If so, which market participants, and why? For example, do commenters believe that the proposed reports would cause harmful information leakage? Why or why not?

- d. As discussed above, increased transparency into order routing practices in the market for NMS stocks may lead broker-dealers to change how they route held orders in ways that reflect positively on their routing decisions, but that may be suboptimal for customers on execution quality dimensions that are less easily observable. Do commenters believe such changes in behavior may occur in the market for OTC Equity Securities and, if so, what would be the likely result on execution quality for customer orders? Please explain.
 - e. Could the proposed disclosure reports lead broker-dealers, such as smaller broker-dealers or broker-dealers with limited activity in OTC Equity Securities, to stop offering services in OTC Equity Securities due to the relative cost of creating the proposed reports or reduced revenues from rebates or payments for order flow? Why or why not?
- 3. How much time would member firms need to make systems and other changes to implement the proposal?
- 4. Under the proposal, the new order routing disclosure reports would be required to be made available in a timeframe, manner and format similar to that required for Rule 606(a) reports. Do commenters agree with this approach? If not, how should the proposed requirements be modified, and why?
 - a. Do commenters agree that reports should be published on a quarterly basis, broken out by calendar month? If not, what alternative timeframe would be appropriate?
 - b. Under the proposal, reports would be required to be made available on a free, publicly accessible website for three years. Do commenters agree with this requirement? If not, how should this requirement be modified? For example, should FINRA consider requiring centralized reporting and dissemination of ordering routing reports, such as through the FINRA website?
- 5. FINRA is proposing that the new quarterly order routing reports be broken out into three categories of OTC Equity Securities. Do commenters agree that the reports should be divided into three sections based on these categories? Why or why not? If not, how should the reports be broken out?
 - a. Are there any operational or other challenges that would be associated with identifying which securities fall into each of the proposed categories?
 - b. Do the proposed categories appropriately capture all relevant types of OTC Equity Securities for purposes of the proposed routing disclosure reports? For example, FINRA understands that there is very limited held customer activity in Global Depository Receipts (GDRs). Should GDRs be covered by the proposed routing disclosure reports? If so, in which category should GDRs be included?

6. Based on initial discussions and feedback from FINRA committees, FINRA is considering whether orders in “grey market” securities should be included in the proposed routing disclosure reports. Grey market securities are OTC Equity Securities for which no quoted prices are published or submitted in a quotation medium for buyers and sellers to access.³⁰ While FINRA understands that grey market securities often involve customized liquidity sourcing, to the extent orders in grey market securities are non-directed, FINRA believes that there would be benefits from public order routing disclosures. FINRA also believes there would be added operational and compliance burdens if the proposed disclosure requirements turn on whether a security was quoted during a given period. In light of these considerations, do you agree that grey market securities should be subject to the proposed quarterly order routing disclosure reports? Why or why not?
 - a. If you believe grey market securities should be treated differently and not subject to the proposed disclosures, what basis do you believe exists to exclude them?
 - b. The SEC recently proposed conditional exemptive relief that would allow the distribution of quotes and data in an “expert market” for securities that would otherwise trade in the grey markets.³¹ If you believe grey market securities should not be subject to the proposed order routing disclosure reports, how do you believe expert market securities should be treated?
7. In line with Rule 606(a), FINRA is proposing that the new reports apply only for held orders in OTC Equity Securities. FINRA is not proposing at this time to require customer-specific disclosures for not held orders in OTC Equity Securities. Do commenters agree with this approach? Why or why not?
 - a. Since customer-specific not held disclosures would not be available, should the quarterly public order routing reports also include not held orders? Why or why not?
 - b. FINRA notes that, in addition to the new customer-specific disclosures for not held orders in NMS stocks under Rule 606(b)(3), Rule 606(b)(1) requires a broker-dealer, on request of a customer, to disclose to its customer the identity of the venue to which the customer’s orders were routed for execution in the six months prior to the request, whether the orders were directed orders or non-directed orders, and the time of the transactions, if any, that resulted from such orders. These limited customer-specific disclosures are required for held orders as well as not held orders for which a more detailed customer-specific report is not required under new Rule 606(b)(3). Do commenters believe that a similar kind of limited customer-specific disclosure requirement for OTC Equity Securities would be beneficial? Why or why not?
8. Do commenters agree with the proposed content of the quarterly order routing disclosure reports? If not, how should the disclosures be modified, and why?

9. Under the proposal, members would be required to disclose the percentage of total held orders that were non-directed orders but, unlike Rule 606(a), would not be required to further break down the disclosures based on whether the orders are market orders, marketable limit orders, non-marketable limit orders and other orders. Do commenters agree with this approach? Why or why not? If not, do commenters believe breaking out disclosures further by order type would provide beneficial information? If so, should disclosures be broken out into the same order types as Rule 606(a) or would a different categorization be more appropriate for OTC Equity Securities?
10. Under the proposal, members would be required to disclose aggregate payments to or from venues both as a total dollar amount and per order, rather than per share as required for NMS stocks under Rule 606(a). Do commenters agree with this approach? Why or why not? Are broker-dealers typically compensated for all orders routed to venues for execution in the OTC market or only for orders that are actually executed at the venue? If compensation is typically only provided for executed orders, should net payment disclosures be provided per executed order only rather than for all orders routed to a venue? Why or why not?
11. Under the proposal, member firms would be required to disclose the identity of the ten venues to which the largest number of total non-directed orders were routed for execution, as well as any venue to which five percent or more of non-directed orders were routed for execution. Do commenters agree with these proposed requirements? Why or why not?
 - a. FINRA understands that there are generally fewer execution venues in the OTC market than for NMS securities. Are the top ten and five percent thresholds for disclosure appropriate for OTC Equity Securities? If not, how should the thresholds be modified, and why?
 - b. Consistent with Rule 606(a), disclosures would be required for venues where non-directed orders are routed for execution. As noted above, FINRA proposes that “venue” would accordingly be interpreted broadly, similar to the SEC’s approach to venues under Regulation NMS.³² Do commenters agree with this aspect of the proposal? If not, how should “venues” be defined for purposes of the proposed disclosures?
 - c. Are there types of market centers or market participants unique to the OTC market that would require a different definition or specific guidance regarding the definition of venue for these purposes? Please be specific. For example, where an alternative trading system (ATS) offers both automatic order execution and order delivery functionality, should the ATS be identified as the venue only when it provides order execution, consistent with SEC guidance for the predecessor to Rule 606?³³ And, in cases where the ATS instead provides order delivery, should the separate market center (e.g., a market maker or other ATS) be identified as the venue?

12. Under the proposal, members would be required to include a discussion of the material aspects of the member's relationship with each identified venue, including a description of any arrangement for payment for order flow and any profit-sharing relationship and a description of any terms of such arrangements, written or oral, that may influence a member's order routing decision. The proposal would also include a non-exhaustive list of such arrangements that would be required to be disclosed. Are the examples of arrangements that must be included relevant to the OTC market? Are there other arrangements in the OTC market that should be specifically referenced? Please specify.
13. As discussed above, while FINRA is not proposing additional requirements at this time, FINRA continues to consider whether other types of disclosures under Regulation NMS may also be appropriate to apply to OTC Equity Securities, including customer-specific disclosures concerning handling of not held orders under Rule 606(b)(3) and execution quality disclosures under Rule 605. FINRA requests comment on whether such additional disclosures would provide useful information to the marketplace. Why or why not? If yes, which market participants would find the disclosures useful? Would certain market participants benefit more than others? If so, which types of market participants and why? Do commenters have any concerns regarding potentially applying these additional disclosure requirements to OTC Equity Securities?
14. Are there any steps FINRA could take to consolidate or otherwise facilitate investors' ability to access and understand existing Rule 606(a) disclosures for NMS securities?
 - a. Do commenters believe these reports can be readily found and accessed by investors?
 - b. Are there freely available resources already available to investors that consolidate the public Rule 606(a) reports across firms?
 - c. If not, do commenters believe it is helpful and appropriate for FINRA to consider steps, such as consolidation, to facilitate investors' access to public Rule 606(a) reports? Should FINRA consider a requirement that firms provide their Rule 606(a) reports to FINRA to support consolidation and investor access?
 - d. Are there any other steps that FINRA could consider to provide investors more education about the public Rule 606(a) reports or otherwise facilitate investors' understanding of the reports?

Endnotes

1. Parties should submit in their comments only personally identifiable information, such as phone numbers and addresses, that they wish to make available publicly. FINRA, however, reserves the right to redact, remove or decline to post comments that are inappropriate for publication, such as vulgar, abusive or potentially fraudulent comment letters. FINRA also reserves the right to redact or edit personally identifiable information from comment submissions.
2. See SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Some proposed rule changes take effect immediately upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.
3. Under FINRA rules, “OTC Equity Security” is defined as any equity security that is not an NMS stock, other than a Restricted Equity Security. See FINRA Rule 6420(f). A “Restricted Equity Security” means any equity security that meets the definition of “restricted security” as contained in Securities Act Rule 144(a)(3). See FINRA Rule 6420(k).
4. See Securities Exchange Act Release No. 62359 (June 22, 2010), 75 FR 37488 (June 29, 2010) (Order Approving File No. SR-FINRA-2009-054); see also FINRA Rules 6434, 6437, 6450 and 6460.
5. See 17 C.F.R. 242.606. Generally, NMS securities include listed stocks and options, and NMS stocks means any NMS security other than an option. See Regulation NMS Rule 600(b).
6. See Securities Exchange Act Release No. 84528 (November 2, 2018), 83 FR 58338 (November 19, 2018) (Disclosure of Order Handling Information; Final Rule) (2018 Amendments Release). The SEC did not specifically define “held” or “not held” orders in amended Rule 606, but stated that typically 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. See *id.* at 58340 n.19. As noted by the SEC in the 2018 Amendments Release, broker-dealers utilize the “held” and “not held” order classifications as a matter of industry practice and to comply with certain regulatory requirements including FINRA OATS technical specifications and the definition of “covered order” in Rule 600(b) of Regulation NMS. See *id.* at 58344.
7. See *id.* at 58371; see also *id.* at 58372 (“...the Commission’s main concern with held NMS stock orders is the impact of intensified competition for customer order flow—particularly retail investor order flow—that has arisen concomitant with the rise in the number of trading centers and the introduction of new fee models for execution services. Financial inducements to attract order flow from broker-dealers that handle retail investor orders have become more prevalent and for some broker-dealers such inducements may be a significant source of revenue. These financial inducements create new, and in many cases significant, potential conflicts of interest for broker-dealers with respect to how they handle held orders from customers—and retail customers in particular. The Commission believes that enhanced public disclosures should focus on providing more detailed information regarding these financial inducements...” (citations omitted)).

8. *See id.* at 58423.
9. FINRA notes that the SEC's Equity Market Structure Advisory Committee (EMSAC) recommended enhancing the current order routing disclosures required under Rule 606 with information about OTC Equity Securities. *See* EMSAC, Recommendations Regarding Modifying Rule 605 and Rule 606 (November 29, 2016) (EMSAC Recommendation) at 3.
10. For purposes of the proposed disclosures, a "non-directed order" would mean any customer order other than a directed order. Consistent with the definition of "directed order" under Regulation NMS, a "directed order" would mean a customer order that the customer specifically instructed the member to route to a particular venue for execution. *See* Regulation NMS Rule 600(b)(19); *see also* 2018 Amendments Release at 58339 n.4.
11. "Held" orders refer to orders that are said to be "held" to the market, and therefore a broker-dealer must attempt to execute a held order immediately. *See supra* Note 6.
12. Rule 606(a) requires reports for NMS securities to be made available using the most recent versions of the XML schema and the associated PDF renderer as published by the SEC on its website. FINRA expects that it would require similar technical formats for the new OTC Equity Security reports and would publish the required specifications on its website.
13. For purposes of these categories of OTC Equity Securities, securities would be delineated based on the market where such securities trade, rather than on the location of the issuer. Therefore, for example, Canadian securities that are listed in Canada and trade OTC in the U.S. market would fall into category (iii) (Canadian-listed securities trading in the United States as OTC Equity Securities), while Canadian securities that trade only OTC in the United States would fall into category (i) (domestic OTC Equity Securities).
14. By contrast, Rule 606(a) requires quarterly reports for NMS securities to have separate sections for: (i) NMS stocks that are included in the S&P 500 Index; (ii) other NMS stocks; and (iii) NMS securities that are options. These categories are not relevant in the OTC market.
15. Rule 606(a) requires disclosures to be further broken out depending on whether orders are market orders, marketable limit orders, non-marketable limit orders and other orders. Given the current structure of the OTC market, FINRA does not believe breaking out disclosures by these order types would provide useful information for OTC Equity Securities at this time. In particular, FINRA understands that members may not differentiate these different types of orders in OTC Equity Securities under current industry practice, in part due to the lack of a national best bid and offer (NBBO) in the OTC market.
16. Consistent with the SEC's approach to Rule 606, FINRA intends that a "venue" for purposes of the proposed disclosures for OTC Equity Securities would be defined broadly to cover any market centers or any other person or entity to which a member routes orders for execution. *See, e.g.,* Securities Exchange Act Release No. 43590 (November 17, 2000), 65 FR 75414, 75427 n.63 (December 1, 2000) (Disclosure of Order Execution and Routing Practices) ("The term "venue" is intended to be interpreted broadly to cover "market centers" within the meaning of Rule 11Ac1-5(a)(14) [now Rule 600(b)(39) of Regulation NMS], as well as any other person or entity to which a broker routes non-directed orders for

execution. Consequently, the term excludes an entity that is used merely as a vehicle to route an order to a venue selected by the broker-dealer.”); *see also* 17 C.F.R. 242.600(b)(39) (“Market center means any exchange market maker, OTC market maker, alternative trading system, national securities exchange, or national securities association.”). In this *Notice*, FINRA seeks comment on the appropriate scope of “venue” for purposes of orders in OTC Equity Securities.

17. FINRA notes that Rule 606(a) requires aggregate payments to or from venues to be disclosed both as a total dollar amount and per share. In light of different pricing practices in the OTC market, FINRA believes it would be appropriate to require payment disclosures for OTC Equity Securities to be provided both as a total dollar amount and per order, rather than per share.
18. Similar to Rule 606(a), the types of arrangements referenced above are not an exhaustive list of terms of payment for order flow arrangements or profit-sharing relationships that may influence a broker-dealer’s order routing decision that would be required to be disclosed. For example, if a broker-dealer receives a discount on executions in other securities or some other advantage in directing order flow in a specific security to a venue, or if a broker-dealer receives equity rights in a venue in exchange for directing order flow there, then all terms of that arrangement would also be required to be disclosed. Similarly, if a broker-dealer receives variable payments or discounts based on order types and the amount of orders sent to a venue, or if the level of execution quality is negotiated for an increase or decrease in payment for order flow, such arrangements would be required to be disclosed. *See* 2018 Amendments Release at 58376 n.397.
19. *See id.* at 58377-78; *see also* EMSAC Recommendation at 2 (recommending that “the SEC could consider centralizing [Rule 605 and 606] report creation in an unbiased and trusted source such as FINRA”).
20. A firm is defined as having Central Registration Depository number.
21. Under Rule 605 (formerly 11Ac1-5), the SEC requires market centers that trade NMS securities to make monthly electronic reports. These reports include information about each market center’s quality of executions on a stock-by-stock basis, including how market orders of different sizes are executed relative to the public quotes. These reports also disclose information about effective spreads and the extent to which executions occur at prices better than the public quotes for marketable orders.
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25. Spatt, C. S., 2020, “Is Equity Market Exchange Structure Anti-Competitive?” Working Paper.
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27. Battalio, Robert, Shawn Corwin, and Robert Jennings, 2016, "Can Brokers Have It All? On the Relation Between Make-Take Fees and Limit Order Execution," *Journal of Finance*, 71, 2193–2238.
28. Di Maggio, Marco, Jerry Liu, Savina Rizova, and Ryan Wiley, 2020, "Exchange Fees and Overall Trading Costs," Working Paper.
29. O'Donoghue, Shawn, 2019, "Transaction Fees: Impact on Order Types, Commissions, and Execution Quality," Working Paper.
30. See Securities Exchange Act Release No. 90769 (December 22, 2020) at 4 n.7.
31. See generally *id.*
32. See *supra* Note 16.
33. See Frequently Asked Questions About Rule 11Ac1-6, Staff Legal Bulletin No. 13A, SEC Division of Market Regulation. Question 12 reads as follows:

"Q: The Adopting Release provides that, to assure meaningful disclosure of significant execution venues, all orders routed to a particular exchange for execution should be aggregated when calculating a broker-dealer's top ten venues and those with 5% of orders. How should a firm make this calculation in the context of Nasdaq systems?

A: Nasdaq should be identified as the execution venue for orders that are routed directly to Nasdaq's order execution systems, such as SOES (or its upcoming replacement, SuperSOES). SelectNet, in contrast, is an order delivery system, not an order execution system, and therefore should not be identified as an execution venue. For orders transmitted directly (whether through SelectNet or otherwise) to an individual market center, such as a market maker or ECN, that market center, rather than Nasdaq, should be identified as the execution venue."

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Attachment A

[Broker Name] – Held OTC Equity Security Routing Public Report

Generated on [Date] [Time]

[Quarter] [Year]

[Month 1] [Year]

* * * * *

Domestic OTC Equity Securities**Summary**

Non-Directed Orders as % of All Orders
[XX.XX%]

Venues

Venue – Non-directed Order Flow	Non-Directed Orders (%)	Net Payment Paid/Received (USD)	Net Payment Paid/Received (cents per order)
[Venue 1]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 2]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 3]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 4]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 5]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 6]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 7]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 8]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 9]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 10]	[XX.XX%]	[XXXX]	[X.XXXX]

Material Aspects:

[Venue 1]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 2]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 3]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 4]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 5]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 6]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 7]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 8]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 9]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 10]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

* * * * *

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[Month 1] [Year]

American Depositary Receipts (ADRs) and Foreign Ordinaries that are OTC Equity Securities**Summary**

Non-Directed Orders as % of All Orders
[XX.XX%]

Venues

Venue – Non-directed Order Flow	Non-Directed Orders (%)	Net Payment Paid/Received (USD)	Net Payment Paid/Received (cents per order)
[Venue 1]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 2]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 3]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 4]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 5]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 6]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 7]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 8]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 9]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 10]	[XX.XX%]	[XXXX]	[X.XXXX]

Material Aspects:**[Venue 1]:**

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 2]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

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[Venue 3]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 4]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 5]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 6]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 7]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 8]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 9]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 10]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

* * * * *

[Month 1] [Year]

* * * * *

Canadian-listed Securities Trading in the United States as OTC Equity Securities

Summary

Non-Directed Orders as % of All Orders
[XX.XX%]

Venues

Venue – Non-directed Order Flow	Non-Directed Orders (%)	Net Payment Paid/Received (USD)	Net Payment Paid/Received (cents per order)
[Venue 1]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 2]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 3]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 4]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 5]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 6]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 7]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 8]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 9]	[XX.XX%]	[XXXX]	[X.XXXX]
[Venue 10]	[XX.XX%]	[XXXX]	[X.XXXX]

Material Aspects:

[Venue 1]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 2]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 3]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

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[Venue 4]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 5]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 6]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 7]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 8]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 9]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

[Venue 10]:

[Insert discussion of the material aspects of the relationship with this venue pursuant to prong (iv).]

* * * * *

[Same disclosures as above for Month 2]

* * * * *

[Same disclosures as above for Month 3]

* * * * *

Exhibit 2b

11/16/22, 1:25 PM

Keith L Hickman Comment On Regulatory Notice 21-35 | FINRA.org



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Keith L Hickman Comment On Regulatory Notice 21-35

Keith L Hickman
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FINANCIAL INFORMATION FORUM

December 2, 2021

By electronic mail to pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 21-35: FINRA Requests Comment on Proposed Order Routing Disclosure Requirements for OTC Equity Securities and Potential Steps to Facilitate Investor Access to Current Order Routing Disclosures for NMS Securities

Dear Ms. Mitchell,

The Financial Information Forum (FIF)¹ appreciates the opportunity to comment on Regulatory Notice 21-35 (the Regulatory Notice) published by the Financial Industry Regulatory Authority (FINRA).² The Regulatory Notice solicits “comment on a proposal to require members to publish quarterly order routing disclosure reports for held orders in OTC Equity Securities.” “The proposed new quarterly reports would be similar to those required for NMS stocks” under Rule 606(a) of Regulation NMS adopted by the Securities and Exchange Commission (the Commission), “with certain modifications reflecting the different structure of the OTC market.” In the Regulatory Notice, “FINRA also requests input on possible steps to further facilitate investor access and understanding of current order routing disclosures for NMS securities.”³ In this letter, we refer to the proposed new quarterly reports for OTC Equity Securities as the “proposed OTC routing reports” or the “OTC routing reports”.

This comment letter does not express either support or opposition to the rule proposal as different FIF members have differing views about the advisability of the proposed routing disclosure reports. This comment letter is focused on achieving the most effective implementation of the new routing reports in the event that FINRA moves forward with this initiative.

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 FINRA Regulatory Notice 21-35 (October 6, 2021), available at <https://www.finra.org/sites/default/files/2021-10/Regulatory-Notice-21-35.pdf> (Regulatory Notice 21-35).

³ Regulatory Notice 21-35, p. 1.

In Section I of this comment letter we discuss the question of which entity should be reported when there are multiple levels of routing for an order. This is a fundamental issue that impacts many of the other issues raised by FINRA in the Regulatory Notice. In Section II of this comment letter we respond to the specific questions raised by FINRA in the Regulatory Notice.

I. Which entity should be reported

A fundamental question to consider for this type of report is the “venue” that should be reported. The Commission’s November 2018 Adopting Release titled “Disclosure of Order Handling Information” (the Rule 606 Amendments Adopting Release) amended Rules 600, 605 and 606 of the Commission’s Regulation NMS. The Rule 606 Amendments Adopting Release describes the purpose of Rule 606(a) as “providing enhanced transparency for financial inducements faced by broker-dealers when determining where to route held NMS stock order flow.”⁴

There are many scenarios where a customer-facing broker-dealer will route an OTC equity order to a second broker-dealer that is neither a market maker nor an alternative trading system. That second broker-dealer will then manage further routing and execution of the order. To understand the financial inducements faced by the customer-facing broker-dealer in this scenario, the relevant information is the payment received by the customer-facing broker-dealer from the second broker-dealer (or, as applicable, the payment made by the customer-facing broker-dealer to the second broker-dealer). Accordingly, to achieve the stated objective of Rule 606(a), as quoted above, it is important that the customer-facing broker-dealer report the second broker-dealer in this scenario.

If the customer-facing broker-dealer instead reports the venue to which the second broker-dealer further routes the customer’s order and the associated fee arrangement between the second broker-dealer and that downstream venue (referred to by industry members as “look-through reporting”), this obscures the financial inducements faced by the customer-facing broker-dealer. In particular, any payment for order flow made by the second broker-dealer to the customer-facing broker will not be disclosed. This is contrary to the stated objective of Rule 606, as quoted above.

The most significant problem with look-through reporting, as described above, is that it obscures the financial inducements faced by the broker-dealer providing the report, thereby negating the purpose for the report. The following are additional problems with look-through reporting:

- Look-through creates unnecessary complexity and confusion for the person reviewing the report because some of the data in the report does not reflect financial arrangements involving the customer-facing broker-dealer. While additional detail can be provided in footnotes, the integrity and comparability of the tabular data is compromised.
- Look-through for Rule 606(a) applies when an entity does not function as a “venue for execution”. Because there is often lack of clarity as to when an entity is functioning as a venue for execution, different broker-dealers take different interpretations as to when look-through applies. This leads to inconsistent reporting across reporting firms.

⁴ Exchange Act Release No. 84528 (Nov. 2, 2018), 83 FR 58338 (Nov. 19, 2018) (“Rule 606 Amendments Adopting Release”).

- Look-through requires a customer-facing broker-dealer to report on financial arrangements to which the customer-facing broker-dealer is not a party. As a general rule, if regulators require reporting about a financial arrangement, the regulators should require that this information be provided by the parties to the arrangement. It is generally problematic to require that a third-party report on financial arrangements involving two other parties because the third-party has limited ability to validate this data.
- Look-through added significantly to the initial implementation costs for broker-dealers in complying with Rule 606 and continues to add to the ongoing operational costs.

There are different ways that the wording proposed in the Regulatory Notice could be modified to address this issue. One approach would be to reference a “venue or broker” where a “venue” is currently referenced and to change “routed for execution” to “routed” or “routed for execution or further routing” or “routed for execution (by the recipient or another party)”.

II. Responses to specific questions from FINRA

In this section, FIF members respond to the specific questions presented by FINRA in the Regulatory Notice.

Question 1: Potential benefits of the report

As noted above, this comment letter does not express either support or opposition to the rule proposal as different FIF members have differing views about the advisability of the proposed routing disclosure reports.

Question 2: Potential costs; unintended consequences

Potential costs

The costs to implement the proposed OTC routing reports will depend on the details of the final rule that is adopted. In particular, if look-through is required, this will greatly increase the cost for the report as significant and ongoing coordination will be required among multiple layers of market participants. Look-through also raises numerous interpretive questions that add significant costs to implementation and ongoing compliance. If the recommendation above to exclude look-through reporting is adopted, this will significantly reduce the implementation and ongoing operational costs.

Unintended consequences

FINRA notes in the Regulatory Notice that “increased transparency into order routing practices in the market for NMS stocks may lead broker-dealers to change how they route held orders in ways that reflect positively on their routing decisions, but that may be suboptimal for customers on execution quality dimensions that are less easily observable.”⁵ FIF members agree with this concern. One approach

⁵ Regulatory Notice 21-35, p. 11.

to address this concern would be for FINRA, in connection with the adoption of an order routing disclosure requirement for OTC equities, to publish guidance to investors on the purpose and content, and potential limitations, of the OTC routing reports. A good example of this type of guidance is the Information Notice issued by FINRA on May 10, 2019 that provides helpful guidance to the public on “Understanding Short Sale Volume Data on FINRA’s Website.”⁶

As an example of guidance that could be provided by FINRA, FINRA could inform investors that there are a significant number of OTC stocks that have a limited number of available execution venues. In many cases, an OTC stock will only have one or two market makers. There is a potential risk that investors viewing the report would see a high percentage of order flow being routed to one or two venues without appropriate context of the limited choices available to the customer-facing broker-dealer. FINRA could identify this as a factor for investors to consider when reviewing a broker-dealer’s OTC routing report.

Question 3: Time period for implementation

The industry required significant time to implement the 2018 amendments to Rules 600, 605 and 606, resulting in the Commission granting an extension of the implementation dates that were provided for in the amendments.⁷ Two significant and related contributors to the implementation delay were the industry’s need for regulatory guidance relating to the amendments and the complexity of the look-through reporting requirements. It is critical that the implementation schedule for any rule change allow sufficient time for industry members to identify and obtain guidance from FINRA on applicable interpretive questions. It is also critical that the wording of the rule allow FINRA sufficient flexibility to address challenges that firms might identify during the implementation process.

Question 4: Reporting timeframe; centralized publication of routing reports

FIF members agree with FINRA’s proposal to maintain the same quarterly reporting timeframe as applies for Rule 606 reporting. FIF members support centralized publication of Rule 606 reports and the proposed OTC routing reports through the FINRA website or a third-party provider website in a manner that can be accessed by all market participants at no cost.

Question 5: Categories of OTC equity securities

FIF members believe that the reporting categories proposed by FINRA are appropriate. FIF members note that there are a significant number of OTC stocks that have a limited number of available execution venues, and that these stocks would not be reported separately based on FINRA’s proposed categories. This is an example where securities with different trading characteristics would be included in the same reporting category. Setting the reporting categories involves a trade-off between providing a report that is comprehensible for individual investors, on the one hand, and providing additional granularity and detail, on the other hand. On the whole, FIF members believe that it is important not to over-complicate the report for individual investors and support the categories proposed by FINRA.

⁶ Available at <https://www.finra.org/rules-guidance/notices/information-notice-051019>.

⁷ Exchange Act Release No. 85714 (Apr. 29, 2019), 84 FR 18136 (Apr. 30, 2019).

It is important that FINRA publish and maintain a file of which symbols are included in each OTC equity category and that this file be accessible to all industry members without charge. Making this file available on a quarterly basis will ensure consistent reporting among member firms.

Question 6: Grey market securities

FIF members agree with FINRA's decision not to provide a separate reporting category for grey market securities. While grey market securities often involve customized liquidity sourcing, the level of trading in grey market securities is de minimis relative to overall trading in OTC equity securities. This means that inclusion of grey market securities within the other proposed reporting categories should not impact the reported data in any meaningful way.

Question 7: Held and not held orders; Rule 606(b)(1)-type report

Held and not held orders

FIF members support FINRA's proposal to limit the OTC routing reports to held orders. The proposed OTC routing reports are intended for retail investors, and limiting the report to held orders is consistent with this objective. As stated by the Commission in the Rule 606 Amendments Adopting Release:

By contrast, the Commission's concern regarding how broker-dealers handle held orders is less about the difficulties posed by more automated, dispersed and complex order routing and execution practices. Rather, the Commission believes that enhanced disclosures for held orders should provide customers with more detailed information including with respect to the financial inducements that trading centers may provide to broker-dealers to attract immediately executable trading interest, as opposed to the different information geared towards not held NMS stock orders that is set forth in Rule 606(b)(3). As noted above and discussed below, the quarterly public disclosures required under Rule 606(a) are indeed being enhanced to provide more detail regarding financial inducements to broker-dealers, and the Commission believes that these disclosures are more appropriately tailored to the characteristics of held order flow and the needs of customers that use held orders.⁸

Rule 606(b)(1)-type report

FIF members support FINRA's proposed approach not to require a Rule 606(b)(1)-type report for OTC equities. FIF members believe that institutions, upon request, can obtain OTC routing information from broker-dealers that is equivalent to the information provided for in Rule 606(b)(1), even though it is not a legal requirement for broker-dealers to provide this information for OTC equities. Accordingly, FIF members do not believe that a separate Rule 606(b)(1)-type report for OTC equities should be required.

⁸ Rule 606 Amendments Adopting Release.

While FIF members do not believe that this should be required, FIF members note that it would not be a significant burden for firms to add OTC equities to the current Rule 606(b)(1) reports.

Question 8: Content of OTC routing reports

FIF members agree with the proposed content for the report subject to the comments set forth in the other sections of this letter. FIF members recommend that the FINRA order routing reports utilize a similar schema as is used for the existing Rule 606(a) reports, to the extent possible, but acknowledge that certain changes to the schema will be required to reflect that the Commission and FINRA reports will have some fields that are different. FIF members propose that the requirement to report on the number of directed orders be removed from the report because the routing decision in these cases is outside of the control of the broker-dealer.

Question 9: Break out by order type

FIF members support FINRA's approach of not breaking out the report by order type. Classifying a limit order as marketable or non-marketable is contingent on a national best bid and offer (NBBO) being available on a continuous basis. Since market makers are not mandated to provide continuous firm quotes for OTC equities, there is no certainty of a BBO being available on a continuous basis for any OTC equity. This means that classifying limit orders as marketable or non-marketable is not feasible. Further, since marketable limit orders share certain characteristics with marketable orders, differentiating between market and limit orders without separately differentiating between marketable and non-marketable limit orders could be misleading.

Question 10: Disclosing aggregate payments

FIF members agree with FINRA's proposal to require reporting of payments per executed order, as this is consistent with current industry practice.

Question 11: Reporting significant venues

Which entities should be reported

For the reasons discussed in detail in Section I of this letter, a customer-facing broker-dealer should report the broker or venue to which the customer-facing broker-dealer routes the customer's order.

Orders executed through OTC Link

There are various order handling scenarios involving OTC Link that will require guidance from FINRA. For example, how should a firm report if it receives a held order from a customer and negotiates that order with one or more market makers through OTC Link? One potential approach in this scenario is for the firm to report any OTC Link market maker that it executes against. FIF members propose that FINRA, prior to the adoption of any final rule, meet with industry members to identify the potential OTC Link scenarios and discuss how they should be reported.

Routes to brokers and venues outside the US

FIF members have two different views about reporting routes to brokers and venues outside the US. FIF proposes that either approach should be permitted and that the reporting firm should indicate on its webpage accompanying the routing reports which approach it has adopted. The following are the two approaches:

- Some FIF members believe that reporting in these scenarios should be consistent with CAT. If a reporting broker-dealer receives a customer order and knows that the order can only be executed outside the US, the broker-dealer should not include that order in its order routing report. This applies even if the foreign issuer has sponsored or unsponsored F shares in the US. If the reporting broker-dealer knows that the order will be executed in the US or is not certain whether the order will be executed in the US or in a foreign country, the broker-dealer should include the order in its order routing report. Consistent with the discussion in Section I of this comment letter, the reporting broker-dealer should report the broker or venue to which the reporting broker-dealer routes the customer order.
- Some FIF members believe that it will be a challenge to identify and filter those scenarios where an order can only be executed outside the US. These FIF members propose that all orders for F shares should be reportable, even if the reporting broker-dealer knows that the order will be executed outside the US. Consistent with the discussion in Section I of this comment letter, the reporting broker-dealer should report the broker or venue to which the reporting broker-dealer routes the customer order.

Under either approach, if a foreign issuer does not have F shares in the US, the order would not be reportable. The discussion above does not address securities that are inter-listed on a US exchange, as those securities would be covered under Rule 606(a), including any applicable exemptions under that rule.

Exemption for venues that receive less than 5% of non-directed orders

The Commission has exempted firms from including on their Rule 606 reports venues that receive less than 5% of a firm's non-directed orders as long as the firm has disclosed on the report venues that have received at least 90% of the firm's total non-directed orders for the applicable section. The Commission has provided the following background relating to this exemption:

Where, however, a broker-dealer routes the great majority of its orders for a section of the report to only a few venues, it also might route orders to other venues that fall within the top ten, but actually receive only a small number of orders. The inclusion of these venues in quarterly reports would not provide materially more useful information to investors, yet could impose a significantly higher compliance burden. Consequently, the Commission has exempted broker-dealers from the disclosure requirements of paragraph (b)(1)(ii) of the Rule with respect to execution venues that receive only a small percentage of the non-directed orders. Under the exemption, a broker-dealer is

not required to identify execution venues that received less than 5% of non-directed orders for a section of the broker-dealer's quarterly report, as long as it has identified the top execution venues that in the aggregate received at least 90% of the broker-dealer's total non-directed orders for the relevant section.⁹

FIF members recommend that FINRA provide this same exemption for the proposed OTC routing reports and that this exemption be incorporated explicitly within the applicable FINRA rule.

Question 12: Material aspects disclosure

FIF members request that FINRA provide additional guidance on the level of detail that would be required for the material aspects disclosure. For example, would the guidance in footnote 397 of the Rule 606 Amendments Adopting Release apply?

Question 13: Rule 606(b)(3) and Rule 605-type disclosures

Rule 606(b)(3)

As discussed in the response to Question 9, market makers are not mandated to provide continuous firm quotes for OTC equities. This means there is no certainty of a BBO being available on a continuous basis for any OTC equity. Since Rule 606(b)(3) execution quality data is based on the NBBO as a benchmark, Rule 606(b)(3) as currently designed would not work for OTC equities.

In addition, FIF members spent significant resources to comply with Rule 606(b)(3), and FIF members are not aware of any demand from customers for a similar-type report for OTC equities. Implementation of the Rule 606(b)(3) look-through requirements has been very challenging for FIF members. Look-through for OTC equities would present the additional challenge of how to report the various OTC negotiation workflows on a look-through basis, including scenarios where a customer-facing broker-dealer engages in negotiation with multiple market makers through the OTC Link ATS. As a potential alternative (as discussed above in the response to Question 7 above), it would not be a significant burden for firms to add OTC equities to the current Rule 606(b)(1) reports.

Rule 605

As discussed in the response to Question 9, market makers are not mandated to provide continuous firm quotes for OTC equities. This means there is no certainty of a BBO being available on a continuous basis for any OTC equity. Since Rule 605 execution quality data is based on the NBBO as a benchmark, Rule 605 as currently designed would not work for OTC equities.

⁹ Division of Market Regulation: Staff Legal Bulletin No. 13, "Frequently Asked Questions About Rule 11Ac1-6", available at <https://www.sec.gov/interps/legal/mrslb13.htm#q2>.

Question 14: Facilitating investor access and understanding of existing Rule 606(a) disclosures

FIF members support centralized publication of Rule 606 reports through the FINRA website or a third-party provider website in a manner that can be accessed by all market participants at no cost. This would provide a significant benefit to the public and industry members.

More generally, FIF members recommend that the SEC, FINRA, the other SROs and FINRA CAT consider how current reporting systems such as the Consolidated Audit Trail can be leveraged to reduce the general reporting burden for firms. In particular, if data is available to the regulators through one reporting system, firms should be relieved of the responsibility to report the same data through another reporting system. One example of FINRA leveraging existing data for reporting purposes is FINRA's weekly reporting of trading information for OTC transactions in NMS stocks and trading information for OTC equity securities executed outside of alternative trading systems, as set forth in FINRA Rules 6110 and 6610.

FIF members recommend that FINRA, in connection with the adoption of an order routing disclosure requirement for OTC equities, provide guidance to investors on the purpose and content, and potential limitations, of the OTC routing reports. A good example of this type of guidance is the Information Notice issued by FINRA on May 10, 2019 that provides helpful guidance to the public on "Understanding Short Sale Volume Data on FINRA's Website."¹⁰

FIF appreciates the opportunity to comment on Regulatory Notice 21-35. 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 Meyerson¹¹
Managing Director, Financial Information Forum

¹⁰ Available at <https://www.finra.org/rules-guidance/notices/information-notice-051019>.

¹¹ The signatory to this comment letter, prior to his current position at FIF, participated as an industry representative on a FINRA Subcommittee on Possible Order Execution and Routing Disclosures in the OTC Marketplace. The views expressed in this letter do not represent the views of FINRA or any FINRA Committee or Subcommittee.



Derrick Chan

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December 6, 2021

Via email at pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 21-35 Order Routing Disclosures for OTC Equity Securities

Dear Ms. Mitchell,

Fidelity Investments¹ appreciates the opportunity to provide comments on FINRA's proposal to require member firms to make publicly available, for each calendar quarter, a report on their routing of non-directed orders in over-the-counter ("OTC") Equity Securities that are submitted on a held basis. The proposed new quarterly reports would be similar to those required for NMS securities under the Securities and Exchange Commission's ("SEC") Rule 606(a) of Regulation NMS, with certain modifications to reflect the different structure of the OTC market. FINRA also requests comment on possible steps to further facilitate investor access and understanding of current order routing disclosures for NMS securities (collectively, the "Proposed OTC Reports" or the "Proposal").²

Fidelity supports FINRA efforts to provide transparency into broker routing and economic practices in OTC Equity Securities, an asset class that has experienced significant growth but remains opaque. Standardized information about the way brokers handle OTC orders can help investors evaluate broker routing decisions, potential conflicts of interest, and the quality of trade executions. Fidelity has repeatedly supported SEC efforts to enhance

¹ Fidelity and its affiliates are leading providers of mutual fund management and distribution, securities brokerage, and retirement recordkeeping services, among other businesses. Fidelity submits this letter on behalf of National Financial Services LLC ("NFS"), a Fidelity Investments company, a SEC registered broker-dealer clearing firm and FINRA member and Fidelity Brokerage Services LLC ("FBS"), a SEC registered introducing broker-dealer, FINRA member, and affiliate of NFS. Fidelity generally agrees with the views expressed by the Financial Industry Forum ("FIF") in their comment letter and we submit this letter to supplement the FIF letters on specific issues.

² *Order Routing Disclosures for OTC Equity Securities*, FINRA Regulatory Notice 21-35 (October 6, 2021) ("Regulatory Notice"), available at: [Regulatory Notice 21-35 | FINRA.org](https://www.finra.org/regulatory-notice/21-35). Capitalized terms have the meanings ascribed to them in the Regulatory Notice.

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transparency of broker order handling and routing practices.³ Securities regulators should be empowering investors to make good trading decisions by creating more transparency around broker executions and execution quality statistics. While the Proposal largely accomplishes these goals, we offer the following recommendations to enhance its effectiveness:

- FINRA and the SEC should consider how various order routing disclosure reports are used in the marketplace and/or could be used together. FINRA and the SEC should coordinate their oversight of order routing reports to ensure consistency in process and interpretation;
- FINRA should make publicly available a list of OTC Equity Securities appearing in each section of the Proposed OTC Reports, and provide further clarity concerning the definition of market center and fees to be disclosed;
- FINRA should consider whether all, or part, of the Proposed OTC Reports could be populated by CAT data; and
- FINRA should work to consolidate all order routing reports on a centralized website and make this content available without cost.

Each of these points is discussed further below.

FINRA and the SEC should consider how various order routing disclosure reports are used in the marketplace and/or could be used together. FINRA and the SEC should coordinate their oversight of order routing reports to ensure consistency in process and interpretation.

SEC Rule 605 currently requires market centers that trade NMS equity securities to make available monthly reports containing statistical information about covered order executions. These reports provide information about each market center's: (i) execution quality on a stock-by-stock basis, including how market orders of various sizes are executed relative to the public quotes; (ii) effective spreads; and (iii) executions at prices better than the public quotes to investors using limit orders. The rule requires, among other items, that the reports are prepared in a consistent, usable, and machine-readable electronic format, and made available for downloading from a website that is free and readily accessible to the public.

Similarly, SEC Rule 606(a) requires broker-dealers that route held, non-directed customer orders in Regulation NMS stocks and listed options to prepare quarterly reports that disclose specific information about their order routing practices. These reports include a discussion of the material aspects of the member's relationship with each identified venue,

³ See Securities and Exchange Commission, Proposed Rule, *Disclosure of Order Handling Information*, Exchange Act Release No. 78309, 81 FR 49432 (July 27, 2016). Fidelity comments available at: <https://www.sec.gov/comments/s7-14-16/s71416-26.pdf>. Securities and Exchange Commission, Proposed Rule, *Regulation of NMS Stock Alternative Trading Systems ("ATS")*, Exchange Act Release No. 76474, 80 FR 80998 (Dec. 28, 2015). Fidelity comments available at: <https://www.sec.gov/comments/s7-23-15/s72315-22.pdf>

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including a description of any arrangement for payment for order flow and any profit-sharing relationship and a description of any terms of such arrangement, written or oral, that may influence a member's order routing decision. The reports are required to be posted on a website that is free and readily accessible to the public for a period of three years from the initial date of posting on the website.

To ensure the Proposed OTC Reports serve their intended audience and meet intended regulatory goals, FINRA and the SEC should consider how various order routing disclosure reports are used in the marketplace and/or could be used together.⁴ It would be good to determine, perhaps through investor testing or outreach, whether investors find the reports useful. For example, Rule 605 reports may not be as helpful to retail investors making broker decisions because they do not contain metrics from the perspective of the retail broker. FINRA might also review how broker-dealers use data from the reports for purposes of meeting their best execution obligations. Similarly, regulators might consider how Rule 605, Rule 606 and the Proposed OTC Reports could be used together, identifying any modifications that might be needed to accommodate that result.

FINRA and the SEC should also coordinate their oversight of order routing reports to ensure consistency in process and interpretation. Although the SEC has historically promulgated order routing disclosures under Rules 605 and 606, we do not object to FINRA promulgating rules regarding order routing disclosures for OTC Equity Securities given FINRA's previous work in the OTC market. However, this course of action will result in broker-dealers creating similar reports for two different regulators.

We would expect that the reporting framework across all three reports – Rule 605 reports, Rule 606 reports, and the Proposed OTC Reports to be consistent. Broker-dealers should not need to create duplicative reporting systems to accommodate similar FINRA and SEC requirements. Similarly, if broker-dealers undertake a new FINRA order routing report framework for OTC securities, regulatory interpretations governing that framework should be consistent, to the extent possible, with SEC interpretations regarding the Rule 605 and 606 reports.

FINRA should make publicly available a list of OTC Equity Securities appearing in each section of the Proposed OTC Reports, and provide further clarity concerning the definition of market center and fees to be disclosed.

The Proposed OTC Reports would be separated into three sections for: (i) domestic OTC Equity Securities; (ii) American Depositary Receipts (ADRs) and foreign ordinaries that are

⁴ The SEC's Spring 2021 Regulatory Agenda notes under the category of Market Structure Modernization, that the Division of Trading and Markets "is considering recommending that the Commission propose rule amendments to modernize rules related to equity market structure such as payment for order flow, best execution (amendments to Rule 605), market concentration, and certain other practices." This proposed rule amendment provides regulators an opportunity to consider how Rule 605, Rule 606 and the Proposed OTC Reports are currently used and could be used together.

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OTC Equity Securities; and (iii) Canadian-listed securities trading in the United States as OTC Equity Securities. FINRA notes that for purposes of these sections, securities would be delineated based on the market where such securities trade, rather than on the location of the issuer.

We generally agree with the proposed three categories of OTC securities, however OTC Equity Securities are not as clearly defined as NMS securities and different firms may make different decisions regarding the reporting section in which they place an OTC Equity Security. To alleviate confusion and promote consistency in reporting, FINRA should make publicly available for free on its website a list of those OTC Equity Securities appearing in each of the proposed categories above, adjusting for ticker symbol changes and relevant corporate actions. By providing a “golden copy” of securities to be placed in each section, FINRA would promote consistency in reporting among member firms, making the reporting more useful to the marketplace. Moreover, this course of action is consistent with previous regulatory requests to report securities in specific categories, such as in the case of the SEC’s Tick Size Pilot.⁵

FINRA should also clearly define what is considered a “market center” for purposes of the Proposed OTC Reports. Consistent with the SEC’s approach to Rule 606, FINRA intends that a “venue” for purposes of the proposed OTC Reports would be broadly defined to cover any market centers or any other person or entity to which a member routes orders for execution. Although Regulation NMS defines the term “market center” in the context of NMS securities, FINRA should consider whether this definition is appropriate for OTC Equity Securities. The OTC market is a decentralized dealer-to-dealer market that has a different market structure than NMS securities and these differences, in the context of what is considered a market center, should be further discussed and evaluated.

Similarly, FINRA should provide further clarity on the types of fees that should be included in the Proposed OTC Reports. While retail broker economic relationships with wholesalers are straightforward, the OTC market has a variety of fees and it is not clear what other types of fees FINRA would expect to be included in the Proposed OTC Reports. For example, it is not clear how OTC quote access fees should be treated for purposes of the Proposed OTC Reports. Further guidance on fees would promote consistency in reporting and make the reports more useful to the marketplace.

Use of Consolidated Audit Trail (“CAT”) data.

Broker-dealers are currently required to report to the CAT all orders or quotes in NMS equity securities, OTC equity securities and listed options. FINRA should explore obtaining data for all, or part, of the Proposed OTC Reports from broker-dealer CAT submissions.

⁵ For the SEC’s Tick Size Pilot, FINRA produced a Pilot Securities Daily List each day, identifying the securities included in the Tick Size Pilot, and the pilot group for each security. Additionally, FINRA produced a Pilot Securities Change List, identifying any changes made to the securities included in the pilot. Changes included name changes, symbol changes, movements from one pilot group to another, or removal from the Tick Size Pilot. See Securities Exchange Act Release No. 34-74892, 80 FR 27515 (May 6, 2015) available at: <https://www.govinfo.gov/content/pkg/FR-2015-05-13/pdf/2015-11425.pdf>

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While certain data fields in the Proposed OTC Reports, such as the proposed requirement to disclose the material aspects of the member's relationship with each venue identified and the specific economics of order routing, would not be information currently available in the CAT, order routing information is information currently reported to the CAT that could be used to populate the Proposed OTC Reports. Given the time and expense that member firms, FINRA, the SEC and the national securities exchanges have dedicated to the CAT, we believe that this potential alternative to broker-dealers creating the Proposed OTC Reports merits further regulatory exploration. To this end, we encourage FINRA to work with the industry to determine the feasibility of deriving all, or part, of the data for the Proposed OTC Reports from the CAT.

FINRA should work to consolidate all order routing reports on a centralized website and make this content available without cost.

FINRA is interested in public feedback on any steps FINRA could take to facilitate investor access to, and understanding of, the existing order handling disclosures for NMS securities required by Rule 606. Today, Rule 606 and 605 reports are generally only posted on individual websites. Accessing, aggregating, and using these reports to draw meaningful conclusions is a time-consuming process. We agree that it would help customers, market participants and researchers to have these available and accessible in a central location.

We recommend that FINRA work with the SEC to consolidate Rule 605 reports, Rule 606 reports and the Proposed OTC Reports in a central location, potentially on the FINRA website. This proposed practice would be analogous to FINRA's current practice of posting different statistics on their website today.⁶ We believe that consolidating all order handling information in one location on the FINRA website will make it easier for market participants to find and view this data and for investors to access and understand the reports.

Importantly, FINRA should provide the reports on this site free of charge. Allowing retail investors to access this data on a no-fee basis will provide investors insight into broker-dealers order handling practices that allows them to make better trading decisions. Broker-dealers who are required by regulation to provide OTC order routing information to FINRA should not have to pay FINRA to receive this information in return.

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⁶ For example, today FINRA publishes over-the-counter (OTC) trading information on a delayed basis for each alternative trading system (ATS) and member firm with a trade reporting obligation under FINRA rules. The trading information is derived directly from OTC trades that ATSS/member firms report to FINRA's equity trade reporting facilities. See <https://otctransparency.finra.org/otctransparency/AtsIssueData>. We suggest that FINRA follow a similar publication construct for order routing reports.

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Fidelity would be pleased to provide further information and to participate in any direct outreach efforts FINRA undertakes regarding the proposal.

Sincerely,

A handwritten signature in blue ink, appearing to read "Derrick Chan", with a stylized flourish at the end.

Derrick Chan

December 6, 2021

Submitted electronically to pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street NW
Washington, DC 20006-1506

RE: FINRA Regulatory Notice 21-35, FINRA Requests Comment on Proposed Order Routing Disclosure Requirements for OTC Equity Securities and Potential Steps to Facilitate Investor Access to Current Order Routing Disclosures for NMS Securities

Dear Ms. Mitchell:

On behalf of LPL Financial ("LPL"), I am pleased to offer our comments in response to the Financial Industry Regulatory Authority ("FINRA") Regulatory Notice 21-35¹. LPL commends FINRA for seeking feedback from member firms on the potential order, which would require quarterly reports for OTC equity securities.

I. Overview of LPL

LPL is a leading retail investment advisory firm, independent broker-dealer and registered investment advisor custodian. We serve more than 19,000 independent financial professionals and over 800 financial institutions by providing them with the technology, research, clearing and compliance services, and practice management programs they need to create and grow thriving practices. LPL enables them to provide guidance to millions of American families seeking wealth management, retirement planning, financial planning and asset management solutions.

II. Comments in Response to Regulatory Notice 21-35

Regulatory Notice 21-35 asks for comment on requiring routing information for held orders in OTC equity securities through quarterly reports. While LPL supports efforts to provide greater transparency as to the handling of orders, this proposal would impose a significant burden on firms without providing useful information to investors. Additionally, the proposed rule should have an exemption for firms that do not receive payment for order flow (PFOF) in order to minimize unnecessary business expenses that could discourage firms from taking orders for OTC equity securities in general.

Limited Benefits

The proposed order would require quarterly public reports with four disclosures intended to increase transparency and make information more accessible to investors. Often, investors are only aware of direct trading costs like commissions and do not have greater insight into other fees. We understand FINRA's desire to provide more insight into costs incurred by the end investor. However, when combined with the existing disclosure rules, this proposal will not lead to additional information for OTC equity securities being made easily accessible to consumers in the same way that it's accessible for NMS securities.

¹ See FINRA Regulatory Notice 21-35 available at: <https://www.finra.org/rules-guidance/notices/21-35>

For NMS securities, the routing disclosure required by SEC Rule 606(a)² can provide investors with useful information because it can be combined with order execution information available pursuant to SEC Rule 605. However, the disclosures proposed by FINRA would not have a parallel provision for disclosure of execution quality. This ultimately means that less information would be available to investors. The proposal would give information about only one aspect of order execution: the amount of PFOF received by the routing firm.³ While relevant, PFOF is not the equivalent of the robust discourse provided by Rule 605⁴. Further, if firms do not receive PFOF then the information disclosed will be limited and not useful.

Increased Burden on Firms

The proposed disclosures would subject firms who take orders for OTC equity securities to additional and costly obligations. These burdens would include internal technology costs to identify and gather the needed data, vendor costs to prepare quarterly reports, and employee time to implement and supervise the disclosure. LPL expects that the initial costs to implement the proposed rule would be similar to the cost of complying with recent amendments to Rule 606.⁵

- When revisions to Rule 606 were enacted in 2018, LPL spent more than \$100,000 on internal technology changes to gather and transmit the needed data.
- Employees from trading, compliance, technology and legal spent hundreds of hours to meet the requirements of amended Rule 606.
- Overall, it took LPL more than a year to come into compliance with Rule 606.
- Our current cost for vendor support for Rule 606 disclosure is \$6,200 per year.

While the proposed rule might entail a smaller effort than Rule 606, the burden would still be significant and increase the cost of doing business. OTC equities are a very small part of LPL's core business; LPL does not allow the purchase of OTC securities classified as Limited Information, No Information, Grey Market or Caveat Emptor and generally prohibits transfers of many OTC equities into LPL accounts. If these disclosures are required, additional burdens for this limited business may have a chilling effect and cause firms to stop accepting orders for OTC equities.

Exemption

Although there has been a lot of recent attention paid to firms that receive PFOF, there are a number of firms that do not receive PFOF, including LPL. Furthermore, LPL does not engage in proprietary trading of OTC equities, except for trade corrections. Imposing the added costs of this proposed disclosure on firms that do not receive PFOF would be both unfair and unproductive. The premise of the proposed rule seems to be to allow investors to judge how PFOF is influencing the routing decisions of the member. Current disclosures inform investors with adequate disclosure that a firm does or does not receive PFOF. If adopted, we ask FINRA to amend the proposed rule to include an exemption from the reporting described Attachment A for firms that do not receive PFOF.

Conclusion

Disclosures are an important way to increase transparency in the markets and provide investors with more information. LPL supports transparency in this area, but we are concerned that the proposed rule would not provide investors with any material information if a firm does not receive PFOF. We urge

² See SEC Rule 606(a) of Regulation NMS, available at: <https://www.sec.gov/rules/final/2018/34-84528.pdf>

³ See Request for Comment #1.

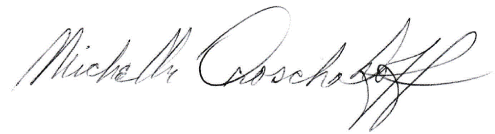
⁴ See SEC Rule 605 of Regulation NMS, available at: <https://www.sec.gov/interps/legal/slbim12a.htm>

⁵ See Request for Comment #2.

FINRA to provide an exemption in the order for firms that do not receive PFOF in order to ease the burden on firms and prevent a chilling effect on the OTC equities market.

Thank you for your consideration of this letter. If you have any questions, please contact Richard Wallace at Richard.Wallace@lplfinancial.com.

Sincerely,

A handwritten signature in black ink, reading "Michelle Oroschakoff". The signature is fluid and cursive, with a large, stylized "M" and "O".

Michelle Bryan Oroschakoff
Chief Legal Officer

December 6, 2021

By email to pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1735 K Street, NW
Washington, DC 20006

RE: Regulatory Notice 21-35: Order Routing Disclosures for OTC Equity Securities and Potential Steps to Facilitate Access to Order Routing Disclosures for NMS Securities

Dear Ms. Mitchell:

I am writing on behalf of the North American Securities Administrators Association, Inc. (“NASAA”)¹ in response to Financial Industry Regulatory Authority (“FINRA”) *Regulatory Notice 21-35: Order Routing Disclosures for OTC Equity Securities and Potential Steps to Facilitate Access to Order Routing Disclosures for NMS Securities* (the “Proposal”),² which would require firms to disclose routing activities for held OTC Equity Securities³ orders in a manner similar to that required for securities subject to Regulation NMS. NASAA supports the Proposal and encourages FINRA to publish order routing reports on its website and provide education to help investors make use of them.

I. The Proposed Reports Would Provide Useful Information and Promote Efficiencies in the Capital Markets.

NASAA believes the Proposal is appropriately tailored to reveal potential conflicts of interest arising from payment for order flow (“PFOF”), profit sharing agreements, transaction rebates and other features of order routing arrangements. We agree with FINRA that the Proposal “would represent an important first step toward increasing transparency around order routing

¹ Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

² The Proposal is available at <https://www.finra.org/sites/default/files/2021-10/Regulatory-Notice-21-35.pdf>.

³ Capitalized terms not defined in this letter are defined in the Proposal.

practices in the OTC market.”⁴ The logic of importing Regulation NMS disclosure requirements into the OTC market is sound given that OTC trading is less transparent than trading conducted on national exchanges. NASAA therefore also supports FINRA’s plan to “consider whether other types of disclosures under Regulation NMS may also be appropriate to apply to OTC Equity Securities.”⁵

As we have commented before Congress and the Securities and Exchange Commission (“SEC”), NASAA is concerned that incentives in certain order routing arrangements, particularly those associated with zero commission trading applications marketed to retail investors, can undermine best execution and the broker-dealer’s duty to act in the best interests of its customers.⁶ FINRA has expressed similar concerns.⁷ NASAA is particularly concerned with the potential for misalignments of interest between broker-dealers and their clients. Because the profitability of PFOF arrangements depends on the volume of trading, broker-dealers may urge investors to make inadvisable trades and build poor investing habits.⁸ Given the increased prevalence of PFOF and

⁴ Proposal at 4.

⁵ *Id.*

⁶ See Letter from Lisa Hopkins, NASAA President, to Hon. Maxine Waters and Patrick McHenry, House Committee on Financial Services, *Re: H.R. 4617 – Order Flow Improvement Act* (July 27, 2021) at 2-3, available at <https://www.nasaa.org/wp-content/uploads/2021/07/NASAA-Letter-to-HFSC-Re-7.28.21-Full-Committee-Markup-Final-in-PDF.pdf>; Letter from Lisa Hopkins, NASAA President, to Vanessa A. Countryman, U.S. Securities and Exchange Commission, *Re: File No. S7-10-21: Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice* (Oct. 1, 2021) (the “NASAA DEP Comment Letter”) at 3-4, available at <https://www.nasaa.org/wp-content/uploads/2021/10/NASAA-Comment-Letter-for-File-No-S7-10-21-Digital-Engagement-Practices-and-Investment-Adviser-Technologies.pdf>; Letter from Michael Pieciak, NASAA President, to Brent J. Fields, U.S. Securities and Exchange Commission, *Re: Supplemental Comment Letter to NASAA’s 2018 Consolidated Comments to SEC Proposed Rulemakings: Regulation Best Interest (File No. S7-07-18), Form CRS Relationship Summary, Amendments to Form ADV, Required Disclosures, and Restrictions on the Use of Certain Names or Titles (File No. S7-08-18), and Standards of Conduct for Investment Advisers (File No. S7-09-18)* (Feb. 19, 2019) at 4-5, available at <https://www.nasaa.org/wp-content/uploads/2019/12/NASAA-Reg-BI-Supplemental-Comment-Letter-021919.pdf>. Indeed, NASAA and our members have commented on these practices and voiced concerns over inadequate disclosure and representations to investors for more than two decades. See Testimony of Mark J. Griffin, NASAA President, before the Subcommittee on Finance and Hazardous Materials of the Committee on Commerce, *Re: H.R. 1053 – the Common Cents Stock Pricing Act of 1997* (April 16, 1997) available at <https://www.nasaa.org/938/nasaa-testimony-on-h-r-1053-the-common-cents-stock-pricing-act-of-1997/>; Letter from Bradley Skolnik, NASAA President, to Jonathan Katz, U.S. Securities and Exchange Commission, *Re: Commission Request for Comment on Issues Relating to Market Fragmentation; Release No. 34-42450* (May 12, 2000), available at <https://www.sec.gov/rules/sro/ny9948/skolnik1.htm>.

⁷ See FINRA Reg. Notice 21-23: *FINRA Reminds Member Firms of Requirements Concerning Best Execution and Payment for Order Flow*, (June 23, 2021), available at <https://www.finra.org/sites/default/files/2021-06/Regulatory-Notice-21-23.pdf>. FINRA’s guidance makes clear that member firms may not let PFOF interfere with their duty of best execution. While NASAA takes no position on the guidance itself, NASAA believes it was important for FINRA to make its position clear and it will be important for FINRA to enforce its best execution rules vigorously going forward.

⁸ NASAA DEP Comment Letter at 5.

related arrangements in retail brokerage accounts – along with increased SEC and state regulatory scrutiny of digital engagement practices⁹ – NASAA believes that the Proposal comes at the right time and would bring additional transparency to trading practices in the OTC market.

II. FINRA Should Publish Order Routing Reports on Its Website.

The Proposal asks whether FINRA should “consider requiring centralized reporting and dissemination of ordering routing reports, such as through the FINRA website.”¹⁰ The most important use of these reports – for investors, regulators, industry and FINRA itself – is to make comparisons among multiple firms to gain a clearer picture of their ordering and trading practices. NASAA therefore believes that consolidating order routing reports on FINRA’s website would serve all stakeholders.¹¹

First, centralization would allow investors to make comparisons easily. The Proposal specifies the contents of the proposed reports and it contemplates uniform XML and PDF formatting,¹² both of which would facilitate comparisons, but only when multiple reports are gathered. Centralization would eliminate that burden. On the other hand, allowing firms to publish their reports separately on various websites increases burdens on investors seeking to make comparisons. FINRA should also be concerned about the possibility that firms might bury the reports on their websites to obfuscate the data, although technically complying with letter of the regulation to be “free and readily accessible.” If one of the goals of the Proposal and Regulation NMS Rule 606 is to allow “customers – and retail investors in particular” to “be better able to assess the quality of order handling services provided by their broker-dealers and whether their broker-dealers are effectively managing potential conflicts of interest,”¹³ then the Proposal should be crafted in a way that allows retail investors to access the information easily.

⁹ Securities and Exchange Commission, *Release No. 34-92766 – Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice* (Sept. 1, 2021), available at <https://www.sec.gov/rules/other/2021/34-92766.pdf>; Avi Salzman, *SEC Chairman says Banning Payment for Order Flow Is ‘On the Table,’* Barron’s (Aug. 30, 2021), available at <https://www.barrons.com/articles/sec-chairman-says-banning-payment-for-order-is-on-the-table-51630350595>; Melanie Lubin, NASAA President, *2021 NASAA Presidential Address* (Sept. 21, 2021), available at <https://www.nasaa.org/58820/2021-nasaa-presidential-address-melanie-senter-lubin-maryland-securities-commissioner/>.

¹⁰ Proposal at 11.

¹¹ While NASAA makes this comment with respect to the proposed reports as requested in the Proposal, the same reasoning would apply to consolidating reports required under Regulation NMS Rule 606(a). NASAA asks FINRA to consider whether those reports should be consolidated as well.

¹² See Proposal at 3 n. 12.

¹³ Proposal at 3 and n. 7 (quoting Exchange Act Rel. No. 84528 (Nov. 2, 2018); 83 F.R. 58338 (Nov. 19, 2018) at 58371).

Centralization would also help inform and facilitate regulatory decisions. Both legislators and regulators have focused recently on potential conflicts of interest arising from PFOF arrangements, and the effect of those arrangements on the quality of order execution.¹⁴ Centralized reporting would help regulators study these issues, which would help determine whether rulemaking is needed and the components of any such rules.

Centralization could also have positive “self-regulatory” effects by causing firms to align their order routing practices. For instance, side-by-side comparisons of disclosures would reveal whether certain firms have reached extraordinary arrangements with venues or whether they have made extraordinary concessions in order to receive payments or rebates. Such insights could cause some firms to bargain for better arrangements, abandon outlier practices that visibly benefit firms over customers, or advertise to customers that they provide better value over other firms. Put another way, the ability of firms to make easy comparisons could enhance competition and ultimately customer value.¹⁵

Finally, centralization would help FINRA analyze compliance with the proposed rule, discover best reporting practices to share with its members, perform comparisons to facilitate risk-based examination selections, and determine whether disclosures give rise to the need for investigation. Centralization would also help FINRA determine how effective the proposed reports are in enhancing competition for order flow and lowering transaction costs (in part by analyzing how disclosures change over time). This in turn would provide FINRA with the data it needs to determine whether further rules are necessary.

¹⁴ Order Flow Improvement Act, H.R. 4617, 117th Cong. (July 22, 2021), *available at* <https://www.congress.gov/bill/117th-congress/house-bill/4617/text>; Chair Gary Gensler, U.S. Securities and Exchange Commission, *Testimony before the House Committee on Financial Services* (Oct. 5, 2021), *available at* <https://www.sec.gov/news/testimony/gensler-testimony-20210505>.

¹⁵ The Proposal asks commenters to consider whether transparency could cause firms to change their behavior in “ways that reflect positively on their routing decisions, but that may be suboptimal for customers on execution quality dimensions that are less easily observable.” Proposal at 11. The Proposal suggests that changes in order routing practices could result in “wider bid-ask spreads, smaller realized spreads, lower fill rates, slower execution or more adverse selection.” *Id.* at 10. The Proposal does not offer data to support this concern, and its logic is uncertain. If current order routing practices provide these benefits to customers and are at the same time more lucrative to firms, it does not make sense that firms would walk away from them for the sake of appearances. If these “less easily observable ... execution quality dimensions” exist, firms are more likely to explain and quantify them with adequate disclosures than to leave money on the table. NASAA is more inclined to believe that increased transparency would drive competition and benefit investors.

III. FINRA Should Provide Education to Help Investors Use Order Routing Reports.

The Proposal seeks comment on how FINRA can facilitate investor access to and understanding of Regulation NMS and the proposed disclosure requirements.¹⁶ NASAA believes investor education is necessary to make these reports useful. This is especially true given that a stated purpose of both the Proposal and Regulation NMS Rule 606 is to empower retail investors to make informed decisions about firm order routing practices. Accordingly, should FINRA decide to require firms to publish the information in a centralized location, FINRA could develop and post information for investors on how to read and interpret the data. If FINRA elects to allow firms to publish the information on their own websites, FINRA should develop standard educational materials that firms can either link to or be required to make available with the reports.¹⁷ Given the rising number of retail investors who are entering the market through zero commission trading applications, we believe it is important for investors to understand these arrangements. NASAA and FINRA frequently collaborate on training initiatives, and we would welcome the opportunity to do so here as well.

Conclusion

For the reasons discussed above, NASAA supports the Proposal and encourages FINRA to centralize order routing reports and teach investors how to use them. We look forward to the rulemaking contemplated by the Proposal, and we encourage FINRA to continue its deliberations into whether further integration of Regulation NMS requirements over OTC market securities is appropriate. If you have any questions or would like additional information, please do not hesitate to contact the undersigned or NASAA's General Counsel, Vince Martinez, at (202) 737-0900.

Sincerely,



Melanie Senter Lubin
NASAA President
Maryland Securities Commissioner

¹⁶ Proposal at 5.

¹⁷ NASAA anticipates that both new and experienced investors would benefit from education. New investors should understand that zero commission trading still entails costs, and that different trades provide differing levels of benefits to broker-dealers. It would be especially useful for investors to discern that an individual firm's PFOF and related arrangements can compel it to suggest products that yield higher compensation for the firm. They should also understand how routing decisions can actually cost them money through relatively poor execution. Education that helps make these analyses clear would facilitate informed decision making. Further, more experienced investors may benefit from understanding that trading with multiple firms does not necessarily reduce counterparty risk if those firms all have arrangements with the same or a limited number of market venues.

EXHIBIT 3

**[Broker Name] –OTC Equity Security Routing Public Report
Generated on [Date] [Time]**

[Quarter] [Year]

[Month 1] [Year]

Domestic OTC Equity Securities**Summary**

Not Held Orders as % of All Orders	Held Orders as % of All Orders	Non-Directed Held Orders as % of Held Orders
[XX.XX%]	[XX.XX%]	[XX.XX%]

Venues

Venue – Non-Directed Held Order Flow	Non-Directed Held Orders (%)	Net Payment Paid/Received (USD)	Net Payment Paid/Received (cents per order)
[Venue 1]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 2]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 3]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 4]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 5]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 6]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 7]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 8]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 9]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 10]	[XX.XX%]	[XXXX]	[X.XXXXX]

Material Aspects:

[Venue 1]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 2]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 3]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 4]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 5]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 6]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 7]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 8]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 9]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 10]:

[Insert discussion of the material aspects of the relationship with this venue]

[Month 1] [Year]

American Depositary Receipts (ADRs) and Foreign Ordinaries that are OTC Equity Securities

Summary

Not Held Orders as % of All Orders	Held Orders as % of All Orders	Non-Directed Held Orders as % of Held Orders
[XX.XX%]	[XX.XX%]	[XX.XX%]

Venues

Venue – Non-Directed Held Order Flow	Non-Directed Held Orders (%)	Net Payment Paid/Received (USD)	Net Payment Paid/Received (cents per order)
[Venue 1]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 2]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 3]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 4]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 5]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 6]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 7]	[XX.XX%]	[XXXX]	[X.XXXXX]

[Venue 8]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 9]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 10]	[XX.XX%]	[XXXX]	[X.XXXXX]

Material Aspects:

[Venue 1]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 2]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 3]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 4]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 5]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 6]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 7]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 8]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 9]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 10]:

[Insert discussion of the material aspects of the relationship with this venue]

[Month 1] [Year]

Canadian-listed Securities Trading in the United States as OTC Equity Securities**Summary**

Not Held Orders as % of All Orders	Held Orders as % of All Orders	Non-Directed Held Orders as % of Held Orders
[XX.XX%]	[XX.XX%]	[XX.XX%]

Venues

Venue – Non-Directed Held Order Flow	Non-Directed Held Orders (%)	Net Payment Paid/Received (USD)	Net Payment Paid/Received (cents per order)
[Venue 1]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 2]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 3]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 4]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 5]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 6]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 7]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 8]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 9]	[XX.XX%]	[XXXX]	[X.XXXXX]
[Venue 10]	[XX.XX%]	[XXXX]	[X.XXXXX]

Material Aspects:

[Venue 1]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 2]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 3]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 4]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 5]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 6]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 7]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 8]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 9]:

[Insert discussion of the material aspects of the relationship with this venue]

[Venue 10]:

[Insert discussion of the material aspects of the relationship with this venue]

[Same disclosures as above for Month 2]

[Same disclosures as above for Month 3]

EXHIBIT 5

Below is the text of the proposed rule change. Proposed new language is underlined
proposed deletions are in brackets.

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6000. QUOTATION, ORDER, AND TRANSACTION REPORTING FACILITIES

6100. QUOTING AND TRADING IN NMS STOCKS

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6151. Disclosure of Order Routing Information for NMS Securities

Every member that is required to publish a report pursuant to Rule 606(a) of SEC Regulation NMS shall provide the report to FINRA, in the manner prescribed by FINRA, within the same time and in the same formats that such report is required to be made publicly available pursuant to Rule 606(a). FINRA will publish such reports on its public website.

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6400. QUOTING AND TRADING IN OTC EQUITY SECURITIES

* * * * *

6470. Disclosure of Order Routing Information for OTC Equity Securities

(a) As detailed in this Rule, every member shall make publicly available for each calendar quarter a report on its routing of orders in OTC Equity Securities that are submitted during that quarter broken down by calendar month and keep such report posted on an internet website that is free and readily accessible to the public for a period of three years from the initial date of posting on the internet website. Such report shall include separate sections for the following categories of OTC Equity Securities, in a manner consistent with the categorization of securities in the list published by FINRA on

its public website: (i) domestic OTC Equity Securities; (ii) American Depositary Receipts (ADRs) and foreign ordinaries that are OTC Equity Securities; and (iii) Canadian-listed securities trading in the United States as OTC Equity Securities. Such report shall be made available using the most recent versions of the XML schema and the associated PDF renderer as published on the FINRA website for such reports. Each section in a report shall include the following information:

(1) the percentage of total orders for the section that were not held orders and held orders, and the percentage of held orders for the section that were non-directed orders;

(2) the identity of the 10 venues to which the largest number of total non-directed held orders for the section were routed for execution and of any venue to which five percent or more of non-directed held orders for the section were routed for execution, and the percentage of total non-directed held orders for the section routed to the venue;

(3) for each venue identified pursuant to paragraph (a)(2) of this Rule, the net aggregate amount of any payment for order flow received, payment from any profit-sharing relationship received, transaction fees paid, and transaction rebates received, both as a total dollar amount and per order, for all non-directed held orders for the section; and

(4) a discussion of the material aspects of the member's relationship with each venue identified pursuant to paragraph (a)(2) of this Rule, including, without limitation, a description of any arrangement for payment for order flow and any profit-sharing relationship and a description of any terms of such arrangements,

written or oral, that may influence a member's order routing decision including, among other things:

(A) incentives for equaling or exceeding an agreed upon order flow volume threshold, such as additional payments or a higher rate of payment;

(B) disincentives for failing to meet an agreed upon minimum order flow threshold, such as lower payments or the requirement to pay a fee;

(C) volume-based tiered payment schedules; and

(D) agreements regarding the minimum amount of order flow that the member would send to a venue.

(b) A member is not required to identify execution venues pursuant to paragraph (a)(2) of this Rule that received less than 5% of non-directed held orders for a section of the member's report required by paragraph (a), provided that the member has identified the top execution venues that in the aggregate received at least 90% of the member's total non-directed held orders for the section.

(c) A member shall make the report required by paragraph (a) of this Rule publicly available within one month after the end of the quarter addressed in the report.

(d) A member shall provide the report required by paragraph (a) of this Rule to FINRA within one month after the end of the quarter addressed in the report in such a manner as may be prescribed by FINRA. FINRA will publish such reports on its public website.

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