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Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Via email to rule-comments@sec.gov

Re: File No. SR-FINRA-2022-031 – Proposed Rule Change to Adopt FINRA Rules 6151 (Disclosure of Order Routing Information for NMS Securities) and 6470 (Disclosure of Order Routing Information for OTC Equity Securities)

Dear Ms. Countryman:

This letter is being submitted by the Financial Industry Regulatory Authority, Inc. (“FINRA”) in response to comments received by the Securities and Exchange Commission (“SEC” or “Commission”) regarding the above-referenced rule filing. The proposed rule change would adopt new 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 Commission published the proposed rule change for public comment in the Federal Register on December 6, 2022.¹ The Commission received four comments on the rule filing.² The following are FINRA’s responses to the material aspects of the comments received.

¹ See Securities Exchange Act Release No. 96415 (November 30, 2022), 87 FR 74672 (December 6, 2022) (Notice of Filing of File No. SR-FINRA-2022-031) (“Proposal”). Any capitalized terms not defined herein shall have the meanings assigned to them in the Proposal.

² See Letter from G.P., dated November 30, 2022; Letter from Daniel Lambden, dated December 5, 2022; Letter from Howard Meyerson, Managing Director, Financial Information Forum, to Vanessa A. Countryman, Secretary, SEC, dated December 20, 2022 (“FIF”); Letter from Howard Meyerson, Managing Director, Financial Information Forum, to Vanessa A. Countryman, Secretary, SEC, dated February 3, 2023 (“FIF Supplemental Letter”).

Centralized Publication of Reports

FIF supported the proposed centralized publication of both the new OTC Equity Security and existing Rule 606(a) disclosure reports. However, FIF stated that firms should then no longer be required to separately publish these reports on their own websites and should be permitted to provide a link from their websites to the FINRA website. FIF also recommended that FINRA consider creating a database with structured firm routing report data that can be accessed through automated queries.³

FINRA confirms that a member would satisfy the proposed requirement to publish the new OTC Equity Security reports on the member's website by including a link from its own website to the FINRA webpage hosting centralized publication of OTC Equity Security reports.⁴ With respect to FIF's recommendation that FINRA create a structured database that users may query, FINRA is not contemplating such a database at the outset. However, FINRA will continue to consider ways to facilitate investor access to, and the usefulness of, the OTC Equity Security disclosure reports.

Symbol Categorization File

FIF supported FINRA's proposal to publish and maintain a file of which symbols are included in each OTC Equity Security category (*i.e.*, domestic OTC Equity Securities, ADRs and foreign ordinaries that are OTC Equity Securities, and Canadian-listed securities trading in the United States as OTC Equity Securities), available to members without charge. FIF recommended making this file available prior to the first day of each quarter, to be used for the upcoming quarter, stating that requiring daily updates to the list would significantly increase the reporting burden without material impact on the aggregated data for the quarter.⁵

FINRA confirms that it will make the symbol categorization file available prior to the first day of each calendar quarter for use during the entirety of the following quarter. Thus, for example, FINRA would make available the symbol file for use for the second quarter of a given year (covering April, May, and June of that year) prior to April 1st, and members would use that file to categorize OTC Equity Security orders for the entirety of the second quarter.

Consolidated Audit Trail

FIF stated that FINRA should consider obtaining and disseminating routing venue data from the Consolidated Audit Trail ("CAT") system, noting that, for firms that do not have payment for order flow and similar financial arrangements with venues to which they route, the CAT

³ See FIF at 7.

⁴ FINRA notes that this Proposal would not in any way alter a firm's existing obligations under the SEC's Rule 606.

⁵ See FIF at 7.

system presumably would have all the data these firms would be required to report under the Proposal.⁶ FINRA continues to believe that the Proposal is the most appropriate means of facilitating order routing disclosure at this time. While some of the data that would be required under the Proposal may also be reported to CAT, not all of this data is reported to CAT. This, together with other considerations regarding when such a use might be feasible, support FINRA's continued belief that the most efficient method to create and publish the required disclosures at this time is to require members to provide the routing information directly.⁷

Execution Venue Disclosure Requirement

FIF opposed the Proposal because it adopts for the new OTC Equity Security disclosures what FIF refers to as the “look-through” approach that the SEC has mandated for reporting execution venues under Rule 606(a).⁸ FIF takes issue with the SEC's requirements for the Rule 606(a) disclosures, pursuant to which firms must report venues to which customer orders were routed for execution, which would not include routing brokers that do not execute orders. Rather, where a reporting firm routes orders to a routing-only broker-dealer, the reporting firm must disclose information relevant to the execution venues to which the routing broker routes customer orders for execution. FIF stated that this approach is problematic for a number of reasons, including, among other things, because the required “look-through” obscures relevant information from retail investors about the reporting firm's financial arrangements with the routing firm. FIF recommended that FINRA instead require that reports disclose information regarding routing broker arrangements, rather than those of the downstream execution venues.⁹

FIF also asserted that requiring firms to report on financial arrangements to which they are not a party is problematic because this requires the reporting firm to collect the data but imposes no obligation on the routing firm to provide such information, and because the reporting firm has

⁶ See id. at 6.

⁷ See Proposal at 74679.

⁸ See FIF at 2.

⁹ See generally id. at 2-6. FIF also asserted that this “look-through” approach was newly implemented by the SEC following the 2018 amendments to Rule 606 “via FAQs, verbal discussions with industry members, Commission and FINRA audits and, most recently, a Risk Alert from the Commission's Division of Examinations.” See id. at 2. FINRA notes that Rule 606(a) and its predecessor, Rule 11Ac1-6, have always required disclosure of venues to which customer orders are routed “for execution.” See, e.g., Disclosure of Order Execution and Routing Practices, Securities Exchange Act Release No. 43590 (November 17, 2000), 65 FR 75414, 75427 n.63 (December 1, 2000) (“The term ‘venue’ is intended to be interpreted broadly to cover ‘market centers’ within the meaning of Rule 11Ac1-5(a)(14), 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.” (emphasis in original)).

no way to effectively validate information received from routing firms, especially in situations involving foreign routing firms that route to foreign exchanges and other foreign venues.¹⁰ FIF further stated that, with the “look-through” approach, the reported data is no longer comparable across broker-dealers because reporting firms sending orders to routing firms would provide information about arrangements between the routing firm and downstream execution venues, while reporting firms routing to other broker-dealers that execute orders would report their own arrangements with those broker-dealers.¹¹

As FINRA stated in the Proposal, FINRA believes that it is appropriate to align the scope of the OTC Equity Security disclosures with the requirements of Rule 606(a) and to remain consistent with the SEC’s approach, including with respect to the requirement that a reporting firm routing to a receiving broker-dealer that does not execute orders disclose information regarding the routing firm’s arrangements with the executing venue.¹² Because the purpose of the proposed disclosures—providing information about members’ order routing practices and potential conflicts of interest related to execution venues—is the same as the purpose of 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. FINRA also notes that members already have experience with 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. Aligning the scope of the Rule 606(a) and OTC Equity Security reports would also reduce potential investor confusion that could arise with parallel reports that do not provide information about the same types of venues.

FINRA continues to believe the Proposal is appropriate in requiring firms to provide information on the routing firm’s arrangements with the executing venue. Firms are responsible for their order handling choices, and the financial arrangements that exist in connection with their order handling decisions are a pertinent part of the mix of information relevant to the reporting firm’s customer. FINRA believes it is reasonable to require the reporting firm to obtain and disclose such relevant information and expects reporting firms to adopt reasonable policies and procedures to comply with the Proposal in this and other regards. As noted in the Proposal, this includes where an execution venue is located abroad.¹³ Further, FINRA believes that requiring disclosure of execution venues would make the reports more easily comparable across reporting firms, as the reports would all include information about the financial inducements that may influence a member’s decision to route to destinations where the order may be executed by the recipient venue.¹⁴

¹⁰ See FIF at 5-6.

¹¹ See *id.* at 4.

¹² See Proposal at 74679.

¹³ See *id.* at 74680.

¹⁴ As discussed above, FINRA intends to align the scope of information required to be disclosed for OTC Equity Securities with the SEC’s approach to disclosures for NMS

Finally, FIF stated that, if FINRA determines to proceed with this aspect of the Proposal, it should redraft the Proposal to accurately reflect the reporting that is required.¹⁵ FIF also stated that the costs of the Proposal's reporting requirement concerning information on the routing firm's arrangements with the executing venue are significant, that the Proposal does not discuss this significant expense, and that if FINRA proceeds with this requirement, it should withdraw the filing and resubmit an updated rule filing that includes the "look-through" approach in the "Anticipated Costs" section.¹⁶

FINRA does not agree with either of these assertions. First, the Proposal is clear concerning the execution venue reporting requirement. As is the case with SEC Rule 606(a), the plain language of proposed Rule 6470(a)(2) requires disclosure of venues to which orders "were routed for execution." This language is unambiguous—it clearly delineates the venues that must be identified in the disclosure reports to those to which the members' covered orders were routed "for execution." If a member routes to another broker-dealer that does not itself execute orders, that receiving broker-dealer would not be an execution venue under the text of the proposed rule. Second, as discussed in the Proposal, FINRA has undertaken an economic impact assessment that analyzed, among other things, the potential costs and benefits of the Proposal as described in the filing, which clearly contemplates disclosure of execution venues rather than routing brokers.¹⁷

stocks under Rule 606. As the SEC staff has stated with respect to Rule 606 disclosures, Rule 606(a)(1)(iv) requires firms to disclose the material aspects of their relationship with their routing broker or execution venues, including a description of any payment for order flow arrangement and any profit-sharing relationship that may influence a firm's routing decision. See SEC Division of Examinations, Risk Alert: Observations Related to Regulation NMS Rule 606 Disclosures (November 10, 2022), at 4. Among other things, the SEC staff has noted that such disclosures would include any arrangements with routing or executing brokers to provide exclusively retail order flow to the routing broker in order to receive payment for order flow under arrangements with their routing brokers, as well as the details of payment for order flow revenue split arrangements with their clearing firm or routing broker. See id. at 5. The SEC staff further noted that such disclosure is applicable to firms that have payment for order flow arrangements with their routing brokers even if the firm chooses the approach of adopting by reference the routing brokers' reports. See id.; see also SEC Division of Trading and Markets, Responses to Frequently Asked Questions Concerning Rule 606 of Regulation NMS, Question 12.01. FINRA would expect a reporting firm to disclose similar information with respect to its arrangements with a routing broker for OTC Equity Securities, if applicable, under proposed Rule 6470(a)(4). FINRA also reiterates that member firms are not relieved of their best execution obligations because of related disclosure requirements. See, e.g., Regulatory Notice 21-23 at 4-5.

¹⁵ See FIF at 6.

¹⁶ See id. at 5-6.

¹⁷ See Proposal at 74675-78.

Categorization of Held and Not Held Orders

FIF supported FINRA's proposal to limit the OTC Equity Security disclosures to non-directed held orders, consistent with the Proposal's focus on retail investors. However, with respect to the proposed requirement to report the percentage of not held and held orders as a percentage of all orders, FIF requested guidance on whether there can be orders that are neither held nor not held orders.¹⁸ In FINRA's view, all orders are either "held" or "not held" because a firm either has price and time discretion to execute the order, or it does not.¹⁹

OTC Equities with a Limited Number of Available Execution Venues

FIF stated that there are a significant number of OTC stocks with a limited number of available execution venues (in many cases, only one or two market centers) and that, therefore, investors may see a high percentage of order flow routed to one or two venues without appropriate context of the limited choices available to the reporting firm. Accordingly, FIF stated that FINRA should identify this as a factor for investors to consider when reviewing the reports. FIF also notes that some firms with lower OTC trading volume could have routing relationships with a limited number of market makers.²⁰

FINRA appreciates that the OTC Equity Security market differs from the NMS Security market in a number of ways, including the number of available execution venues. As discussed in the Proposal, FINRA intends to, as appropriate, provide members, investors, and others with information, and otherwise engage in investor education efforts, about the purpose, content, and potential limitations of the reports.²¹

¹⁸ See FIF at 8.

¹⁹ Consistent with SEC guidance regarding the categorization of held and not held orders for purposes of Rule 606(a), orders should be categorized as held or not held for purposes of the OTC Equity Security disclosures based on whether the customer reasonably expects the firm to attempt to execute its order immediately or instead reasonably expects the firm to use its price and time discretion to execute the order. See SEC Division of Trading and Markets, Responses to Frequently Asked Questions Concerning Rule 606 of Regulation NMS, Questions 15.01 through 15.04.

²⁰ See FIF at 8.

²¹ See Proposal at 74678. FINRA notes that members could also provide additional explanatory context regarding their OTC Equity Security reports, provided that such information is accurate, not misleading, and otherwise complies with other applicable SEC and FINRA requirements.

Sufficiency of Comment Period

FIF asserted that the SEC has not provided an adequate period of time to comment on this “highly problematic rule proposal,” particularly because FINRA is “only introducing look-through” in the rule filing stage and did not discuss it in *Regulatory Notice 21-35*.²² FINRA notes that the federal securities laws prescribe the process necessary for a national securities association, such as FINRA, to adopt a proposed rule change, and the Proposal was submitted to the SEC in accordance with the federal securities laws.²³ Further, FIF’s assertion that FINRA is “only introducing look-through” in the rule filing stage is inaccurate. While FINRA is not required to publish a *Regulatory Notice* prior to filing a proposed rule change, in this case, as discussed in the Proposal, FINRA published *Regulatory Notice 21-35*, in which FINRA specifically stated that, “[c]onsistent 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.”²⁴ Indeed, FIF provided comments regarding the “look-through” in response to *Regulatory Notice 21-35*²⁵ and FINRA addressed those comments in the Proposal.²⁶

Implementation Timeframe

FIF stated that it is critical for FINRA to provide an implementation schedule for the Proposal with sufficient time for members to identify and obtain guidance from FINRA on interpretive questions.²⁷ FIF also stated that any implementation timeframe should run from the date that FINRA publishes specifications and guidance.²⁸ As discussed in the Proposal, FINRA recognizes that members will require sufficient time to implement the new disclosure requirements and intends to provide an appropriate amount of time for implementation of the Proposal. As is always the case, FINRA will work with the industry to publish technical specifications appropriately in advance of the implementation date. FINRA will also publish interpretive

²² See FIF at 10.

²³ See 15 U.S.C. 78s(b) and 17 CFR 240.19b-4.

²⁴ See *Regulatory Notice 21-35* at 13; see also *Regulatory Notice 21-35* at 16-17 n.16.

²⁵ See Letter from Howard Meyerson, Managing Director, FIF, to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, dated December 2, 2021, at 2-3.

²⁶ See Proposal at 74679.

²⁷ For example, and among other things, FIF raised questions regarding the application of the Proposal to various routing scenarios, including scenarios involving OTC Link. See FIF at 6.

²⁸ See *id.* at 9-10.

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guidance to the extent needed—for example, on routing scenarios unique to certain platforms in the OTC Equity Security market²⁹—with sufficient time allowed for implementation.³⁰

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FINRA believes that the foregoing responds to the material issues raised by the commenters on the rule filing. If you have any questions, please contact me at (202) 728-8012 or robert.mcnamee@finra.org.

Sincerely,

/s/ Robert McNamee

Robert McNamee
Associate General Counsel
Office of General Counsel

²⁹ See FIF Supplemental Letter.

³⁰ See Proposal at 74680.