

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.
 22. Zhao, Xin, and Kee H. Chung, 2007, “Information Disclosure and Market Quality: The Effect of SEC Rule 605 on Trading Costs,” *The Journal of Financial and Quantitative Analysis*, 42, 657-682.
 23. Boehmer, Ekkehart, Robert Jennings, and Li Wei, 2006, “Public Disclosure and Private Decisions: Equity Market Execution Quality and Order Routing,” *The Review of Financial Studies*, 20: 315–358.
 24. Angel, J., Larry Harris, and Chester Spatt, 2011, “Equity Trading in the 21st Century,” *Quarterly Journal of Finance*, 1, 1–53.
 25. Spatt, C. S., 2020, “Is Equity Market Exchange Structure Anti-Competitive?” Working Paper.
 26. Cimon, David, 2020, “Broker Routing Decisions in Limit Order Markets,” *Journal of Financial Markets*, forthcoming.

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."

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).]

* * * * *

[Month 1] [Year]

American Depository 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).]

[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).]

[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]

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[Same disclosures as above for Month 3]

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