



September 23, 2016

Via Electronic Submission: rule-comments@sec.gov

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-14-16; Disclosure of Order Handling Information

Dear Mr. Fields:

Managed Funds Association¹ (“MFA”) appreciates the opportunity to submit comments to the Securities and Exchange Commission (the “Commission” or “SEC”) on its proposed rule regarding “Disclosure of Order Handling Information” (the “Proposal”).² MFA strongly supports the Commission’s initiative to enhance order handling disclosure to investors and believes that it could improve transparency and the ability of investors to evaluate their execution quality. However, to be clear, we believe that the Proposal should set a minimum or “floor” for broker-dealers to make order handling disclosure to institutional customers. It should not limit the information broker-dealers provide or how it’s provided to investors.

I. Background

As noted in the Proposal, MFA, the Investment Company Institute (“ICI”) and the Securities Industry and Financial Markets Association (“SIFMA”), jointly submitted a letter to the Commission on October 23, 2014, regarding customer-specific order routing disclosure for institutional investors (the “Associations Letter”).³ The Associations Letter included a template

¹ Managed Funds Association (“MFA”) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

² 81 Fed. Reg. 49,432 (July 27, 2016) (hereinafter, the “Proposal”), available at: <https://www.federalregister.gov/articles/2016/07/27/2016-16967/disclosure-of-order-handling-information>.

³ See Letter to Mary Jo White, Chair, SEC, from Dorothy M. Donohue, Deputy General Counsel, ICI, Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, and Randy Snook, Executive Vice

providing recommendations on a minimum level of disclosure to be provided by broker-dealers upon institutional investor request, of useful, reliable and uniformly prepared customer-specific order routing information.

On July 13, 2016, the Commission voted to issue the Proposal, which would require broker-dealers to disclose the handling of institutional orders to customers. As summarized by the Commission, the Proposal would:

[R]equire a broker-dealer to provide a customer, upon request, a report on its handling of that customer's institutional orders (orders in exchange-listed stocks with an original market value of at least \$200,000), containing specified monthly data for the previous six months. The customer-specific report also would require detailed order handling information for each venue to which the broker-dealer routed institutional orders for the customer and would be presented in the aggregate and broken down by passive, neutral, and aggressive order routing strategies.⁴

MFA appreciates that the Proposal has taken into consideration many of the comments from the Associations Letter.

II. Comments

MFA generally supports the Proposal and believes it would assist institutional investors with obtaining standardized information about their broker-dealers' order routing practices and execution quality; and beginning a dialogue with their broker-dealers about order routing practices and the management of conflicts of interest. MFA raises, however, a few comments below for the Commission's consideration.

A. Promoting Order Routing Disclosure

As the Commission recognizes, institutional customers seek and receive different and varying levels of information from their broker-dealers. We support creating a minimum level of order routing disclosure which broker-dealers would provide, upon request, to an institutional customer. Our hope is for the Proposal to serve as a tool for investors in seeking and obtaining greater information and understanding with respect to how their orders are routed and executed. In this respect, we believe a uniform template for the order routing disclosures could assist institutional customers in comparing order routing and execution across broker-dealers. We would be concerned, however, if the Proposal served to create a uniform standard by which investors would be required to review order routing information and analyze best execution, or limited the ability of investors to obtain different information.

President, SIFMA, dated October 23, 2014, available at: <https://www.managedfunds.org/issues-policy/mfa-comment-letters/mfa-ici-sifma-order-routing-disclosure-template-recommendation-sec/>.

⁴ SEC Proposes Rules to Enhance Order Handling Information Available to Investors, SEC Press Release, July 13, 2016, available at: <https://www.sec.gov/news/pressrelease/2016-140.html>.

The Commission has recognized that:

execution price and speed are not the sole relevant factors in obtaining best execution of investor orders. . . and that other factors may be relevant, such as (1) the size of the order, (2) the trading characteristics of the security involved, (3) the availability of accurate information affecting choices as to the most favorable market center for execution and the availability of technological aids to process such information, and (4) the cost and difficulty associated with achieving an execution in a particular market center.⁵

This continues to be true. Accordingly, we believe customers should be able to continue receiving and using different types of information for conducting their own analyses of best execution.

B. Institutional Customer Reports

MFA believes that the broker-dealer reports, in response to customer requests for information on order routing under proposed Rule 606(b), should cover all orders by institutional investors and not just with respect to “institutional orders” defined as NMS stock orders that have a market value of at least \$200,000.⁶ For strategic reasons, institutional investors may break up their own orders for submission to broker-dealers. We note that the Proposal addresses child orders under proposed Rule 606(b)(3) by requiring that a broker-dealer “include the handling of all smaller orders derived from the institutional order.”⁷ Nevertheless, if an institutional investor submitted multiple orders, each just under \$200,000, to a broker-dealer, such orders would not be captured in an institutional customer order routing report. We believe proposed Rule 606(b)(3) should be agnostic to an institutional investor’s execution strategy.

Accordingly, MFA recommends that the Commission eliminate the \$200,000 threshold for determining orders to be included by a broker-dealer in an institutional customer order routing report. For purposes of determining who is an “institutional customer” for proposed Rule 606(b), we believe the Commission should either reference Financial Industry Regulatory Authority

⁵ See 65 Fed. Reg. 75,414 (Dec. 1, 2000) at 75,418, (“Disclosure of Order Execution and Routing Practices”), available at: <https://www.gpo.gov/fdsys/pkg/FR-2000-12-01/pdf/00-30131.pdf>.

⁶ Proposal at 49,509. Proposed Rule 600(b)(31): *Institutional order* means an order to buy or sell an NMS stock that is not for the account of a broker or dealer and is an order for a quantity of an NMS stock having a market value of at least \$200,000.

⁷ Proposal at 49,510.

(“**FINRA**”) Rules 2210(a)(4)⁸ and 4512(c) or adopt a definition that is consistent with FINRA’s rules.⁹

C. New or Small Broker-Dealers and a *De Minimis* Exemption

The Proposal asks whether a rule should include a *de minimis* exemption for broker-dealers that receive, in the aggregate, less than a certain threshold number or dollar value of institutional orders.¹⁰ We believe that broker-dealers with ten or fewer customers should not have to provide a quarterly report on institutional order handling per proposed Rule 606(c). We are concerned that new or small broker-dealers that only have a few customers would essentially be disclosing to the public the confidential order routing information of their customers. Broker-dealers should only need to provide quarterly public reports once they have enough customers and order volume that an aggregated report would mask individual customer order routing information.

Conversely, we believe new or small broker-dealers should be required to provide, upon request, institutional customer order routing reports per proposed Rule 606(b). An institutional customer may try using a new broker-dealer. However, if an institutional customer is not able to compare order routing by the new broker-dealer with the institutional customer’s existing broker-dealer(s), it could be difficult for the institutional customer to evaluate whether it is receiving best execution or justify use of the new broker-dealer.

⁸ FINRA Rule 2210, Communications with the Public, available at: http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=16964&element_id=10648&highlight=2210#16964. FINRA Rule 2210(a)(4): “Institutional investor” means any:

- (A) person described in Rule 4512(c), regardless of whether the person has an account with a member;
- (B) governmental entity or subdivision thereof;
- (C) employee benefit plan, or multiple employee benefit plans offered to employees of the same employer, that meet the requirements of Section 403(b) or Section 457 of the Internal Revenue Code and in the aggregate have at least 100 participants, but does not include any participant of such plans;
- (D) qualified plan, as defined in Section 3(a)(12)(C) of the Exchange Act, or multiple qualified plans offered to employees of the same employer, that in the aggregate have at least 100 participants, but does not include any participant of such plans;
- (E) member or registered person of such a member; and
- (F) person acting solely on behalf of any such institutional investor.

⁹ FINRA Rule 4512, Customer Account Information, available at: http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=9958. FINRA Rule 4512(c): For purposes of this Rule, the term “institutional account” shall mean the account of:

- (1) a bank, savings and loan association, insurance company or registered investment company;
- (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or
- (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million.

¹⁰ Proposal at 49,449 and 49,461.

Accordingly, MFA believes that the Commission should provide a broker-dealer with a *de minimis* exemption from the requirements of proposed Rule 606(c), Quarterly report on institutional order handling, but not with respect to proposed Rule 606(b), Customer requests for information on order routing. MFA recommends that the Commission set the *de minimis* exemption threshold at ten or fewer customers.

D. Order Routing Strategy Categories

MFA believes that the Commission should provide broker-dealers with greater flexibility in categorizing their order routing strategies for proposed Rule 606(b) customer reports. MFA agrees in theory that it would be helpful to an institutional investor to have its broker-dealer categorize its order routing strategies as passive, neutral, and/or aggressive.¹¹ MFA is concerned, however, that in practice, especially as order routing strategies evolve, strategies may not fit neatly into the Commission's definitions and that the definitions may impede the development of order routing algorithms or practices in the future. As order routing algorithms have become increasingly more sophisticated, individual algorithms may include different elements, such as aggressive, neutral or passive, depending upon the orders in the market or the market conditions. Moreover, broker-dealers may categorize similar hybrid strategies differently than other broker-dealers, which would result in very different reports to customers and make it difficult for customers to understand how to compare order routing strategies across broker-dealers.

In addition, MFA is concerned that the Proposal's order routing strategy definitions could have the inadvertent effect of dictating broker-dealer order routing practice instead of serving as a tool for how broker-dealers provide order routing information to customers. We do not want the Proposal to limit the types of order routing strategies available to institutional investors or for broker-dealers to have to shoe-horn their routing strategies to fit the report. The Proposal and the rules thereunder should facilitate broker-dealer reporting of order routing for institutional investors, rather than shape the order-routing strategies used by broker-dealers. We believe that this could be achieved in a number of ways. The Commission could consider amending the Proposal to require that broker-dealers provide a short, general description for strategy category under proposed Rule 606(b). This could be as simple as "generally aggressive, but may become passive under certain market conditions." This would provide broker-dealers with greater flexibility and allow them to explain a hybrid order routing strategy.

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¹¹ See Proposal at 49,510 (providing that an institutional customer order routing report include "information for each venue to which the broker or dealer routed institutional orders for the customer, in the aggregate and broken down by passive, neutral, and aggressive order routing strategies as defined in paragraph (b)(3)(v) of this section").

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MFA appreciates the opportunity to provide comments on the Proposal. If the Commission or its staff have any questions, please do not hesitate to contact Jennifer Han, Associate General Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel
Managed Funds Association