

WILLIAMS & JENSEN, PLLC

AGENCY MEETING REPORT

DATE OF MEETING: November 18, 2015

SUBJECT: Regulation of NMS Stock Alternative Trading Systems

AGENCY: Securities and Exchange Commission (SEC)

STAFF MEMBERS COVERING MEETING: Rebecca Konst and Alex Barcham

Summary

At a November 18, [open meeting](#) the Securities and Exchange Commission (SEC) voted unanimously to approve “amendments to Rule 3a1-1 and Regulation ATS and new Form ATS-N under the Securities Exchange Act of 1934 related to certain alternative trading systems.”

More details as to the open meeting are contained within this report.

Amendments to Rule 3a1-1 and Regulation ATS and new Form ATS-N

The Commission voted unanimously to “propose amendments to Rule 3a1-1 and Regulation ATS as well as new Form ATS-N.”

The proposed rule was approved by a unanimous vote and will be subject to a 60 day comment period following publication in the *Federal Register*.

SEC Staff Overview

According to the SEC Staff Fact Sheet:

“Action

The Securities and Exchange Commission will consider whether to propose amendments that would require Alternative Trading Systems (ATS) that trade stocks listed on a national securities exchange (NMS stocks), including “dark pools,” to publicly disclose detailed information about the operations and activities of a broker-dealer operator and its affiliates. The proposed amendments would enhance transparency and oversight of alternative trading systems.

Highlights of the Proposed Amendments

Detailed Disclosure of the Operations of NMS Stock ATs

The detailed information disclosed on new Form ATS-N would provide market participant with important information regarding potential conflicts of interest that

may be present when a broker-dealer operator's business interest competes with the interests of market participants that access its ATS. The enhanced disclosures would enable market participants to better assess an ATS' operations and make more informed decisions regarding its order routing. It would also enhance the Commission's ability to oversee this segment of the equity market.

Specifically, Form ATS-N would require an NMS Stock ATS to disclose information regarding:

- Activities of its broker-dealer operator, and the broker-dealer operator's affiliates, including:
 - Operation of non-ATS trading centers and other NMS Stock ATSs;
 - Products or services offered to subscribers;
 - Arrangements with unaffiliated trading centers;
 - Trading activities on the NMS Stock ATS;
 - Use of smart order routers (or similar functionality) or algorithms to send or receive subscriber orders;
 - Shared employees that service the operations of the NMS Stock ATS and any other business unit or affiliate of the broker-dealer operator;
 - Service providers to the NMS Stock ATS;
 - Differences in the availability of services, functionalities, or procedures available to subscribers, as compared to the broker-dealer operator, and its affiliates; and
 - Safeguards and procedures established to protect confidential trading information.
- The manner of operations of the NMS Stock ATS, including:
 - Subscribers;
 - Types of orders; connectivity, order entry, and co-location;
 - Segmentation of order flow and notice of segmentation provided to any persons; display of orders and other trading interest;
 - Trading services, including rules and procedures governing priority, pricing methodologies, allocation, matching, and execution;
 - Procedures governing trading during a suspension, system disruption or malfunction;
 - Opening, reopening, and closing processes, and after hours procedures; outbound order routing;
 - Use of market data;
 - Fees;
 - Procedures regarding trade reporting and clearance and settlement;
 - Order display and execution access;
 - Fair access standards; and
 - Market quality statistics published or provided by the NMS Stock ATS to one or more subscribers.

Public Availability of Form ATS-N

The Commission's website would make public each NMS Stock ATS' Form ATS-N and amendments. In addition, each NMS Stock ATS would be required to make public on its website a direct URL hyperlink to the Commission's website where these documents are located.

Commission Review of Form ATS-N Filings

The proposal would provide a process for:

- The Commission to review Form ATS-N filings for compliance with the form requirements and consistency with federal securities laws.
- The Commission to review and declare, by order, initial filings on Form ATS-N effective or ineffective.
- An NMS Stock ATS to file amendments to Form ATS-N and the Commission to review and declare, by order, Form ATS-N Amendments ineffective.

Safeguards and Procedures Protecting Subscriber's Confidential Trading Information

The proposal would amend Regulation ATS to require all ATSS to have and maintain written safeguards and procedures to protect the confidential trading information of their subscribers, and written procedures to ensure that those safeguards and procedures are followed.

Background

In 1998, the Commission adopted Regulation ATS, which established a new regulatory framework designed to encourage market innovation, while ensuring basic investor protections.

It gave securities markets a choice to register as a national securities exchange, or operate as an alternative trading system, which would be required to register as a broker-dealer and comply with Regulation ATS.

Since the adoption of Regulation ATS, the equity markets have evolved substantially and ATSS have become a significant source of liquidity in NMS stocks, accounting for approximately 15 percent of volume in NMS stocks. ATSS that trade NMS stocks generally operate with complexity and sophistication similar to registered national securities exchanges, which applicable laws and regulations require to be transparent trading venues.

Currently, although Regulation ATS requires disclosure of an NMS Stock ATS' operations to the Commission, it is not public. Despite the evolution in equity market, and the growth of NMS stock trading on ATSS since 1998, information available to market participants about the operation of ATSS that trade NMS stocks is often limited. In addition, little information is available to market participants about the relationship between these ATSS and the other business operations of their broker-dealer operators.

What's Next?

If approved for publication by the Commission, the proposed amendments will be published on the Commission's website and in the Federal Register. The comment period for the proposed amendments will be 60 days after publication in the Federal Register."

Commissioner Statements

Chair Mary Jo White in a [statement](#) explained the equity markets have evolved since adoption of the Regulation ATS. She stated equity trading now occurs every day across 11 exchanges and many ATSS and broker-dealers. She stated ATS trading of NMS stocks is a significant source of liquidity for market participants. She noted these ATSS compete with exchanges. **White** stated Regulation ATS remains vastly the same without many disclosures to the public. She stated the information available does not allow deeper analysis or comparisons between trading venues. She noted ATSS can conduct operations which raise conflicts of interest. She suggested it is time to amend Regulation ATS to “shine more light” on this market. She stated this recommendation is a significant step towards transparency, modernization and enhancement of market structure. She explained that those ATSS operating in NMS stocks will be required to provide detailed information on issues including fees, how they handle orders, market data, and conflicts of interest. She stated that the new Form ATS-N would be filed with the SEC and made public. She stated the enhanced transparency would be concentrated in activities of broker-dealer and affiliates to highlight possible conflicts of interest and information into the manner in which ATSS operate. **White** said these ATSS would be subject to direct SEC oversight. She stated the SEC would review and determine whether a new Form ATS-N is effective or not effective after hearing and notice. She explained the SEC could halt changes to an ATS and after hearing and notice suspend, limit, or revoke an ATS’ exemption from operating as an exchange if warranted. **White** stated staff is preparing a recommendation on disclosures on how investor trades are routed and executed which will complement these ATS disclosures. She stated serious consideration must be given to additional transparency considerations in the fixed-income markets. She welcomed comment on treatment of Treasury platforms. She stated the recommendation would require all ATSS to have written policies and procedures to protect subscriber’s confidential trading information. She stated confidentiality of subscriber information is of utmost importance when transacting on ATSS.

Commissioner Luis Aguilar in a [statement](#) explained the SEC today considers much needed enhancements to Regulation ATS. He expressed support for these enhancements as they will help investors. He stated today there are over 40 active ATSS. **Aguilar** suggested there has been an over four fold increase in trading on ATSS. He stated ATSS can offer attractive enticements. He added that ATSS allow for large blocks of trades to be traded without impacting the markets. **Aguilar** noted these ATSS are known as Dark Pools. He stated all too often the safety of these Dark Pools has proved illusory. He noted many Dark Pool operators have allowed their own proprietary desks access to the Dark Pool. He stated the desire for liquidity has led to a failure to properly manage conflicts of interest. He stated the SEC has brought several enforcement actions against Dark Pools related to conflicts of interest. **Aguilar** noted the SEC has also brought actions against Dark Pools because of failures to protect confidential information and providing HFT advantages. He suggested this litany of misuse has led to market participants losing confidence in Dark Pools and creating a new buy side only trading venue. **Aguilar** stated the creation of this new pool is a clear warning that the market is not operating as it should. He stated market participants lack information into the operation of these ATSS. He stated the rules and amendments being considered would require more detailed information about ATS operations and should highlight conflicts of interest. He stated the additional disclosures will go a long way to enabling investors to make more informed decisions. He suggested the SEC should consider whether additional reforms are warranted. He asked whether Regulation ATS should be

expanded to cover platforms trading government securities. **Aguilar** stated ATSs will continue to play a role in the markets but the SEC should consider the future of block trading. He asked a series of questions including whether the volume of orders executed in Dark Pools should be limited, whether the size of Dark Pools should be limited, and whether ATSs are the best method for executing block trades.

Commissioner Kara Stein stated many ATSs are referred to as Dark Pools. She stated too many Dark Pools are a mystery. She stated this proposal seeks to “shine some light” into ATSs. She explained an ATS is an electronic order matching system operated by a broker-dealer. **Stein** stated there are many types of ATS. She stated unlike an exchange which must publicly disclose prices at which quotes and trades occur, an ATS only has to disclose limited information. **Stein** stated one of the first ATSs was launched in 1996 and directly competed with exchanges. She noted ATSs began handling more block trades and had a growing foot print in the markets. She stated Regulation ATS began to integrate these trading systems into the regulatory framework. She noted Regulation ATS provided an exemption from SEC registration as an exchange and did not include transparency requirements. **Stein** stated by 2009 the number of active Dark Pools had grown to 42 and accounted for 8 percent of all shares traded. She noted it is currently estimated that over 2 billion NMS shares are traded on these alternative trading venues. She stated this is now a significant part of the capital markets. She suggested the line between ATSs and exchanges has become “blurry.” She stated the current average trade size of 200 shares is not that different than on exchange. She suggested the volume of trades has grown to the point where the question must be asked whether it is impacting price discovery. **Stein** stated this proposal relies heavily on disclosure and is an important first step. She stated greater transparency should benefit both issuers and investors. She added that the new Form ATS-N requires ATSs to answer some basic questions about the range of services of the ATSs. She noted ATSs would be required to disclose any potential conflicts of interest. Most importantly, she stated the proposed rule would require the ATS to report important performance metrics provided to one or more subscribers. However, she asked whether this does enough. She asked whether there are certain conflicts of interest which should be addressed in different ways. **Stein** asked whether the SEC proposal is creating a new subset of ATSs.

Commissioner Michael Piwowar in a [statement](#) explained he has been critical of recent SEC processes to develop rulemakings but he expressed support for the process used in this instance. He stated this proposal will help the SEC with better market oversight and will help investors make informed decisions. He explained this is not a merit system but is about disclosure and disclosure alone. He asked for comments on whether this proposal strikes the right balance or whether it erases the line between ATSs and exchanges. He asked whether market participants will have access to relevant and useful information at the time it would actually be relevant. He asked whether making operational details public would result in ATS’s changing operations. He stated the proposal contemplates the SEC determining whether a Form ATS-N is appropriate or not and he asked whether this is appropriate. He asked whether the proposal is balanced or not.