

# SEC Amendments May Launch New Execution Disclosure Era

By **Charlie Sommers, Andrew Blake and Michael Ogershok** (May 21, 2024)

On March 6, in a unanimous vote, the U.S. Securities and Exchange Commission adopted amendments to the disclosure requirements under Rule 605 of Regulation NMS for executions on covered orders in national market system stocks.[1]

The Rule 605 amendments seek to modernize and enhance execution quality reporting, and, among other things, (1) expand the scope of entities subject to Rule 605, (2) modify the categorization and content of order information required to be reported, and (3) require reporting entities to produce a summary report of execution quality.

The Rule 605 amendments will become effective on June 14, with a compliance date of Dec. 14, 2025, which provides for an 18-month compliance period after the effective date.

## Background

Currently, Rule 605 requires "market centers"[2] to make available, on a monthly basis, standardized information concerning execution quality for covered orders in NMS stocks that they received for execution, including specified measures of execution quality such as the effective spread, the average amount of price improvement, the number of shares executed and the speed of execution. Rule 605 provides visibility into the execution quality among different market centers, but it has not been substantively updated since its adoption in 2000.

Since Rule 605's adoption, equity markets have evolved with new technologies and business models. The Rule 605 amendments seek to modernize and enhance execution quality reporting to increase transparency and information available to investors, as well as to help promote competition among market centers and broker-dealers.

The Rule 605 amendments are the first to be adopted of four separate proposed rulemakings by the SEC from December 2022 related to the U.S. equity market structure.[3]

## Rule 605 Amendments

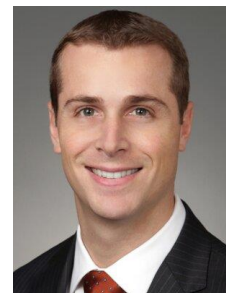
### ***Expanding Entities Subject to Rule 605 to Cover Large Broker-Dealers***

The Rule 605 amendments expand the scope of reporting entities subject to Rule 605, including by requiring monthly execution quality reporting from larger broker-dealers — meaning broker-dealers that introduce or carry 100,000 or more customer accounts.

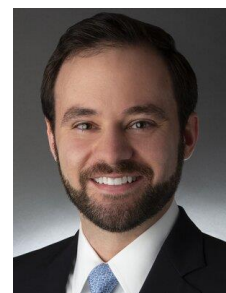
Currently, broker-dealers are not included within the scope of Rule 605 unless they are also market centers. Although Rule 606 of Regulation NMS requires broker-dealers to provide certain information regarding customer orders they route, those reports do not include



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comprehensive information about the execution quality achieved by such routing broker-dealers. The Rule 605 amendments are thus designed to require broker-dealers that introduce or carry more than 100,000 customer accounts to provide execution quality disclosures under Rule 605 to better inform investors of the execution quality that they receive.[4]

The Rule 605 amendments also specify that broker-dealers operating single-dealer platforms must prepare a separate report for activity specific to such platforms.

### ***Amending Form and Content of Rule 605 Monthly Reports***

The Rule 605 amendments also include updates to the scope and content of Rule 605 standardized monthly reports.

First, the Rule 605 amendments expand the definition of a "covered order"[5] subject to Rule 605 to include:

- Orders submitted outside of regular trading hours: The amended definition includes nonmarketable limit orders submitted outside of regular trading hours that become executable after the opening or reopening of trading during regular trading hours;
- Orders submitted with stop prices: Orders with special handling instructions, including orders submitted with stop prices, are currently excluded from the definition of "covered order" — under the Rule 605 amendments, stop orders are required to be reported from the time such orders become executable;[6] and
- Nonexempt short sale orders: Under the Rule 605 amendments, a nonexempt short sale order would only be considered a special handling order, which is excluded from the definition of "covered order," if a price test restriction is in effect for the security.

Second, current Rule 605 reports group orders by order size and order type, and the Rule 605 amendments modify existing order size categories. Specifically, the Rule 605 amendments modify existing order size categories to base them on both notional dollar value and whether an order is for a fractional share, for an odd-lot, or for a round lot or greater — rather than just using the number of shares, as Rule 605 currently does today.

The Rule 605 amendments also modify reportable order type categories for order types as follows:

Existing Order Type Category	Order Type Category as Amended
Market	Market  Marketable immediate-or-cancel (“IOC”)  Executable market order with stop price
Marketable limit	Marketable limit  Marketable IOC  Executable marketable limit order with stop price
Inside-the-quote limit	Midpoint-or-better limit orders  Midpoint-or-better IOCs  Executable NMLO  Executable NMLO submitted with stop price  NMLO IOCs
At-the-quote limit	
Near-the-quote limit	

Third, the Rule 605 amendments amend the content of Rule 605 monthly reports to include:

- The average time to execution, measured in increments of a millisecond or finer, and on a share-weighted basis for all orders — current time-to-execution reporting categories remain under the Rule 605 amendments;
- The average realized spread[7] statistics calculated at 50 milliseconds, one second, 15 seconds, one minute and five minutes after the time of execution; and

- New statistical measures of execution quality, including:
  - The average effective over average quoted spread — a percentage-based metric that represents how much price improvement an order received — for marketable order types, marketable stop order types, and midpoint-or-better order types;
  - Percentage-based effective and realized spread statistics — designed to make it easier to compare dollar-based statistics across stocks — for marketable order types, marketable stop order types, and midpoint-or-better limit order types;
  - A size improvement benchmark that could be used to calculate whether orders received an execution of more than the displayed size at the quote; and
  - Certain statistical measures that could be used to measure the execution quality of nonmarketable orders, and additional price improvement statistics for market and marketable orders showing price improvement relative to the best available price in the market.

### ***Summary Reports***

The Rule 605 amendments require all entities subject to Rule 605 to make publicly available a summary report formatted in the most recent versions of the schema for CSV and PDF formats, as published on the SEC's website. Currently, the required format of 605 reports is only machine-readable.

Requiring summary reports, in addition to the detailed reports, would allow for a human-readable format that could be more readily used by investors.

### **Key Takeaways**

The Rule 605 amendments will increase data made available under Rule 605 to the public about securities transaction execution quality. Affected entities should review the Rule 605 amendments and consider the mechanisms by which they can capture and report the newly proposed information.

The Rule 605 amendments expand the scope of reporting entities subject to Rule 605 to include larger broker-dealers that introduce or carry 100,000 or more customer accounts. This means all broker-dealers will need to develop processes for monitoring the number of customer accounts they introduce or carry to determine whether they may be subject to

Rule 605 disclosure requirements.

Certain aspects of the Rule 605 amendments raise interpretive questions and operational challenges for broker-dealers. For example, under the Rule 605 amendments, broker-dealers that execute fractional share transactions on behalf of their customers may be considered over-the-counter market makers subject to Rule 605 — potentially subjecting such broker-dealers to Rule 605, even if they do not qualify as a larger broker-dealer. Additionally, OTC market makers will be required to provide separate Rule 605 disclosures with respect to their single-dealer platform activities, as distinct from their OTC market-making activities.

The Rule 605 amendments, however, do not set forth a definition of a "single-dealer platform" or provide clear guidance as to how OTC market-making activity should be distinguished from single-dealer platform activity. All self-regulatory organizations that are participants in the Rule 605 NMS plan will be required to amend the Rule 605 NMS plan to account for new data fields.

However, there is no timeline for when an amended Rule 605 NMS plan is required and no requirement that the Rule 605 NMS plan create a template for market participants to use in creating their Rule 605 reports.

While Rule 605 reports have been useful to industry participants and academics conducting reviews for best execution and other purposes, we believe they are currently too complicated, too hard to understand and, overall, of little utility to the average public investor. Certain of the Rule 605 amendments adopted by the SEC will hopefully improve public investors' experiences.

The adoption of these changes provides an excellent opportunity for both the SEC and the Financial Industry Regulatory Authority to provide desperately needed guidance to public investors as to what this information means and how it can be used. A significant amount of the information provided in Rule 605 reports — and to be provided in the updated reports — is very complex and difficult to understand, and serious guidance is needed to make the reports useful for the public investor.

Additionally, the SEC and FINRA should provide guidance to industry participants as to how regulators expect this information to be used and considered. Such guidance will be much more productive to the market than negotiated discussion in ad hoc enforcement actions over the years to come.

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[1] Exchange Act Release No. 99679 (Mar. 6, 2024), 89 Fed. Reg. 26428 (Apr. 15, 2024), <https://www.govinfo.gov/content/pkg/FR-2024-04-15/pdf/2024-05556.pdf>.

[2] Regulation NMS defines a "market center" to include any exchange market maker, OTC

market maker, alternative trading system, national securities exchange, or national securities association.

[3] See SEC Press Release, SEC Proposes Rules to Amend Minimum Pricing Increments and Access Fee Caps and to Enhance the Transparency of Better Priced Orders (Dec. 14, 2022), <https://www.sec.gov/news/press-release/2022-224>; SEC Press Release, SEC Proposes Rule to Enhance Competition for Individual Investor Order Execution (Dec. 14, 2022), <https://www.sec.gov/news/press-release/2022-225>; SEC Press Release, SEC Proposes Regulation Best Execution (Dec. 14, 2022), <https://www.sec.gov/news/press-release/2022-226>.

[4] According to the SEC's analysis, approximately 85 broker-dealers introduce or carry more than 100,000 customer accounts, and these large broker-dealers collectively handle over 98% of customer accounts.

[5] A "covered order" includes any market order or any limit order (including immediate-or-cancel orders) received by a market center during regular trading hours at a time when the national best bid and national best offer is being disseminated, and, if executed, is executed during regular trading hours. See 17 CFR 242.600(b)(22) (upon the effectiveness of the Rule 605 amendments, the defined term "covered order" will be relocated to Rule 600(b)(27)).

[6] The Rule 605 amendments' definition of "executable" means, for any order submitted with a stop price, that the stop price has been triggered during regular trading hours and after the primary listing market has disseminated its first firm, uncrossed quotations in the security.

[7] See 17 CFR 242.600(b)(13), as amended by the Rule 605 amendments (defining "average realized spread").