



December 6, 2021

By email to [pubcom@finra.org](mailto:pubcom@finra.org)

Jennifer Piorko Mitchell  
Office of the Corporate Secretary  
Financial Industry Regulatory Authority, Inc.  
1735 K Street, NW  
Washington, DC 20006

**RE: Regulatory Notice 21-35: Order Routing Disclosures for OTC Equity Securities and Potential Steps to Facilitate Access to Order Routing Disclosures for NMS Securities**

Dear Ms. Mitchell:

I am writing on behalf of the North American Securities Administrators Association, Inc. (“NASAA”)<sup>1</sup> in response to Financial Industry Regulatory Authority (“FINRA”) *Regulatory Notice 21-35: Order Routing Disclosures for OTC Equity Securities and Potential Steps to Facilitate Access to Order Routing Disclosures for NMS Securities* (the “Proposal”),<sup>2</sup> which would require firms to disclose routing activities for held OTC Equity Securities<sup>3</sup> orders in a manner similar to that required for securities subject to Regulation NMS. NASAA supports the Proposal and encourages FINRA to publish order routing reports on its website and provide education to help investors make use of them.

**I. The Proposed Reports Would Provide Useful Information and Promote Efficiencies in the Capital Markets.**

NASAA believes the Proposal is appropriately tailored to reveal potential conflicts of interest arising from payment for order flow (“PFOF”), profit sharing agreements, transaction rebates and other features of order routing arrangements. We agree with FINRA that the Proposal “would represent an important first step toward increasing transparency around order routing

<sup>1</sup> Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

<sup>2</sup> The Proposal is available at <https://www.finra.org/sites/default/files/2021-10/Regulatory-Notice-21-35.pdf>.

<sup>3</sup> Capitalized terms not defined in this letter are defined in the Proposal.

practices in the OTC market.”<sup>4</sup> The logic of importing Regulation NMS disclosure requirements into the OTC market is sound given that OTC trading is less transparent than trading conducted on national exchanges. NASAA therefore also supports FINRA’s plan to “consider whether other types of disclosures under Regulation NMS may also be appropriate to apply to OTC Equity Securities.”<sup>5</sup>

As we have commented before Congress and the Securities and Exchange Commission (“SEC”), NASAA is concerned that incentives in certain order routing arrangements, particularly those associated with zero commission trading applications marketed to retail investors, can undermine best execution and the broker-dealer’s duty to act in the best interests of its customers.<sup>6</sup> FINRA has expressed similar concerns.<sup>7</sup> NASAA is particularly concerned with the potential for misalignments of interest between broker-dealers and their clients. Because the profitability of PFOF arrangements depends on the volume of trading, broker-dealers may urge investors to make inadvisable trades and build poor investing habits.<sup>8</sup> Given the increased prevalence of PFOF and

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<sup>4</sup> Proposal at 4.

<sup>5</sup> *Id.*

<sup>6</sup> See Letter from Lisa Hopkins, NASAA President, to Hon. Maxine Waters and Patrick McHenry, House Committee on Financial Services, *Re: H.R. 4617 – Order Flow Improvement Act* (July 27, 2021) at 2-3, available at <https://www.nasaa.org/wp-content/uploads/2021/07/NASAA-Letter-to-HFSC-Re-7.28.21-Full-Committee-Markup-Final-in-PDF.pdf>; Letter from Lisa Hopkins, NASAA President, to Vanessa A. Countryman, U.S. Securities and Exchange Commission, *Re: File No. S7-10-21: Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice* (Oct. 1, 2021) (the “NASAA DEP Comment Letter”) at 3-4, available at <https://www.nasaa.org/wp-content/uploads/2021/10/NASAA-Comment-Letter-for-File-No-S7-10-21-Digital-Engagement-Practices-and-Investment-Adviser-Technologies.pdf>; Letter from Michael Pieciak, NASAA President, to Brent J. Fields, U.S. Securities and Exchange Commission, *Re: Supplemental Comment Letter to NASAA’s 2018 Consolidated Comments to SEC Proposed Rulemakings: Regulation Best Interest (File No. S7-07-18), Form CRS Relationship Summary, Amendments to Form ADV, Required Disclosures, and Restrictions on the Use of Certain Names or Titles (File No. S7-08-18), and Standards of Conduct for Investment Advisers (File No. S7-09-18)* (Feb. 19, 2019) at 4-5, available at <https://www.nasaa.org/wp-content/uploads/2019/12/NASAA-Reg-BI-Supplemental-Comment-Letter-021919.pdf>. Indeed, NASAA and our members have commented on these practices and voiced concerns over inadequate disclosure and representations to investors for more than two decades. See Testimony of Mark J. Griffin, NASAA President, before the Subcommittee on Finance and Hazardous Materials of the Committee on Commerce, *Re: H.R. 1053 – the Common Cents Stock Pricing Act of 1997* (April 16, 1997) available at <https://www.nasaa.org/938/nasaa-testimony-on-h-r-1053-the-common-cents-stock-pricing-act-of-1997/>; Letter from Bradley Skolnik, NASAA President, to Jonathan Katz, U.S. Securities and Exchange Commission, *Re: Commission Request for Comment on Issues Relating to Market Fragmentation; Release No. 34-42450* (May 12, 2000), available at <https://www.sec.gov/rules/sro/ny9948/skolnik1.htm>.

<sup>7</sup> See *FINRA Reg. Notice 21-23: FINRA Reminds Member Firms of Requirements Concerning Best Execution and Payment for Order Flow*, (June 23, 2021), available at <https://www.finra.org/sites/default/files/2021-06/Regulatory-Notice-21-23.pdf>. FINRA’s guidance makes clear that member firms may not let PFOF interfere with their duty of best execution. While NASAA takes no position on the guidance itself, NASAA believes it was important for FINRA to make its position clear and it will be important for FINRA to enforce its best execution rules vigorously going forward.

<sup>8</sup> NASAA DEP Comment Letter at 5.

related arrangements in retail brokerage accounts – along with increased SEC and state regulatory scrutiny of digital engagement practices<sup>9</sup> – NASAA believes that the Proposal comes at the right time and would bring additional transparency to trading practices in the OTC market.

## **II. FINRA Should Publish Order Routing Reports on Its Website.**

The Proposal asks whether FINRA should “consider requiring centralized reporting and dissemination of ordering routing reports, such as through the FINRA website.”<sup>10</sup> The most important use of these reports – for investors, regulators, industry and FINRA itself – is to make comparisons among multiple firms to gain a clearer picture of their ordering and trading practices. NASAA therefore believes that consolidating order routing reports on FINRA’s website would serve all stakeholders.<sup>11</sup>

First, centralization would allow investors to make comparisons easily. The Proposal specifies the contents of the proposed reports and it contemplates uniform XML and PDF formatting,<sup>12</sup> both of which would facilitate comparisons, but only when multiple reports are gathered. Centralization would eliminate that burden. On the other hand, allowing firms to publish their reports separately on various websites increases burdens on investors seeking to make comparisons. FINRA should also be concerned about the possibility that firms might bury the reports on their websites to obfuscate the data, although technically complying with letter of the regulation to be “free and readily accessible.” If one of the goals of the Proposal and Regulation NMS Rule 606 is to allow “customers – and retail investors in particular” to “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,”<sup>13</sup> then the Proposal should be crafted in a way that allows retail investors to access the information easily.

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<sup>9</sup> Securities and Exchange Commission, *Release No. 34-92766 – Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice* (Sept. 1, 2021), available at <https://www.sec.gov/rules/other/2021/34-92766.pdf>; Avi Salzman, *SEC Chairman says Banning Payment for Order Flow Is ‘On the Table,’* *Barron’s* (Aug. 30, 2021), available at <https://www.barrons.com/articles/sec-chairman-says-banning-payment-for-order-is-on-the-table-51630350595>; Melanie Lubin, *NASAA President, 2021 NASAA Presidential Address* (Sept. 21, 2021), available at <https://www.nasaa.org/58820/2021-nasaa-presidential-address-melanie-senter-lubin-maryland-securities-commissioner/>.

<sup>10</sup> Proposal at 11.

<sup>11</sup> While NASAA makes this comment with respect to the proposed reports as requested in the Proposal, the same reasoning would apply to consolidating reports required under Regulation NMS Rule 606(a). NASAA asks FINRA to consider whether those reports should be consolidated as well.

<sup>12</sup> See Proposal at 3 n. 12.

<sup>13</sup> Proposal at 3 and n. 7 (quoting Exchange Act Rel. No. 84528 (Nov. 2, 2018); 83 F.R. 58338 (Nov. 19, 2018) at 58371).

Centralization would also help inform and facilitate regulatory decisions. Both legislators and regulators have focused recently on potential conflicts of interest arising from PFOF arrangements, and the effect of those arrangements on the quality of order execution.<sup>14</sup> Centralized reporting would help regulators study these issues, which would help determine whether rulemaking is needed and the components of any such rules.

Centralization could also have positive “self-regulatory” effects by causing firms to align their order routing practices. For instance, side-by-side comparisons of disclosures would reveal whether certain firms have reached extraordinary arrangements with venues or whether they have made extraordinary concessions in order to receive payments or rebates. Such insights could cause some firms to bargain for better arrangements, abandon outlier practices that visibly benefit firms over customers, or advertise to customers that they provide better value over other firms. Put another way, the ability of firms to make easy comparisons could enhance competition and ultimately customer value.<sup>15</sup>

Finally, centralization would help FINRA analyze compliance with the proposed rule, discover best reporting practices to share with its members, perform comparisons to facilitate risk-based examination selections, and determine whether disclosures give rise to the need for investigation. Centralization would also help FINRA determine how effective the proposed reports are in enhancing competition for order flow and lowering transaction costs (in part by analyzing how disclosures change over time). This in turn would provide FINRA with the data it needs to determine whether further rules are necessary.

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<sup>14</sup> Order Flow Improvement Act, H.R. 4617, 117th Cong. (July 22, 2021), *available at* <https://www.congress.gov/bill/117th-congress/house-bill/4617/text>; Chair Gary Gensler, U.S. Securities and Exchange Commission, *Testimony before the House Committee on Financial Services* (Oct. 5, 2021), *available at* <https://www.sec.gov/news/testimony/gensler-testimony-20210505>.

<sup>15</sup> The Proposal asks commenters to consider whether transparency could cause firms to change their behavior 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.” Proposal at 11. The Proposal suggests that changes in order routing practices could result in “wider bid-ask spreads, smaller realized spreads, lower fill rates, slower execution or more adverse selection.” *Id.* at 10. The Proposal does not offer data to support this concern, and its logic is uncertain. If current order routing practices provide these benefits to customers and are at the same time more lucrative to firms, it does not make sense that firms would walk away from them for the sake of appearances. If these “less easily observable ... execution quality dimensions” exist, firms are more likely to explain and quantify them with adequate disclosures than to leave money on the table. NASAA is more inclined to believe that increased transparency would drive competition and benefit investors.

**III. FINRA Should Provide Education to Help Investors Use Order Routing Reports.**

The Proposal seeks comment on how FINRA can facilitate investor access to and understanding of Regulation NMS and the proposed disclosure requirements.<sup>16</sup> NASAA believes investor education is necessary to make these reports useful. This is especially true given that a stated purpose of both the Proposal and Regulation NMS Rule 606 is to empower retail investors to make informed decisions about firm order routing practices. Accordingly, should FINRA decide to require firms to publish the information in a centralized location, FINRA could develop and post information for investors on how to read and interpret the data. If FINRA elects to allow firms to publish the information on their own websites, FINRA should develop standard educational materials that firms can either link to or be required to make available with the reports.<sup>17</sup> Given the rising number of retail investors who are entering the market through zero commission trading applications, we believe it is important for investors to understand these arrangements. NASAA and FINRA frequently collaborate on training initiatives, and we would welcome the opportunity to do so here as well.

**Conclusion**

For the reasons discussed above, NASAA supports the Proposal and encourages FINRA to centralize order routing reports and teach investors how to use them. We look forward to the rulemaking contemplated by the Proposal, and we encourage FINRA to continue its deliberations into whether further integration of Regulation NMS requirements over OTC market securities is appropriate. If you have any questions or would like additional information, please do not hesitate to contact the undersigned or NASAA's General Counsel, Vince Martinez, at (202) 737-0900.

Sincerely,



Melanie Senter Lubin  
NASAA President  
Maryland Securities Commissioner

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<sup>16</sup> Proposal at 5.

<sup>17</sup> NASAA anticipates that both new and experienced investors would benefit from education. New investors should understand that zero commission trading still entails costs, and that different trades provide differing levels of benefits to broker-dealers. It would be especially useful for investors to discern that an individual firm's PFOF and related arrangements can compel it to suggest products that yield higher compensation for the firm. They should also understand how routing decisions can actually cost them money through relatively poor execution. Education that helps make these analyses clear would facilitate informed decision making. Further, more experienced investors may benefit from understanding that trading with multiple firms does not necessarily reduce counterparty risk if those firms all have arrangements with the same or a limited number of market venues.