

July 12, 2021

Hon. Maxine Waters  
Chairwoman  
Committee on Financial Services  
U.S. House of Representatives  
Washington, D.C. 20515

Hon. Patrick McHenry  
Ranking Member  
Committee on Financial Services  
U.S. House of Representatives  
Washington, D.C. 20515

Hon. Brad Sherman  
Chairman  
Subcommittee on Investor Protection,  
Entrepreneurship, and Capital Markets  
Committee on Financial Services,  
U.S. House of Representatives  
Washington, D.C. 20515

Hon. Bill Huizenga  
Ranking Member  
Subcommittee on Investor Protection,  
Entrepreneurship, and Capital Markets  
Committee on Financial Services  
U.S. House of Representatives  
Washington, D.C. 20515

Re: Legislation Regarding Equity Market Structure Reforms

Dear Chairwoman Waters, Ranking Member McHenry, Chairman Sherman, Ranking Member Huizenga, and Members of the Committee:

We appreciate the Committee's helpful examination of the many issues raised by recent market events, including trading related to so-called "meme" stocks and the collapse of Archegos Capital Management. We understand that the Committee is considering legislative proposals to address potential market problems identified. In general, we are supportive of the clear intent of much of these proposals.

In response to Chairwoman Waters' public invitation during the May 6, 2021 hearing *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part III*, we write to offer strong support for your draft legislation to prohibit order routing inducements, but also recommend some important enhancements.

We believe that reforms to equity market structure should be focused on maximizing the stability and integrity of the markets--goals that you all believe in--and ensuring that investors are getting the best prices for their securities.

Conflicts of interest in order routing have been a concern for investors for many years, and we thank the Committee for its bold legislative proposal to prohibit payment for order flow for both off and on exchange trading.

Unfortunately, simply eliminating conflicted routing payments is not enough. Brokers may route orders to venues that provide inferior execution quality to customers for a

number of reasons, including that they may be seeking to avoid (i) access and data fees of exchanges<sup>1</sup> or other venues, (ii) developing and operating the necessary infrastructure to survey the various venues and route orders,<sup>2</sup> and (iii) developing and operating compliance and review processes.

Both the Securities and Exchange Commission and FINRA have extensive rules regarding “best execution,” and brokers’ obligations to their customers when executing customer orders. Given recent enforcement actions and press reports, there are significant questions about whether many current industry practices violate those rules and related guidance.

Additional steps to protect investors and ensure customer execution quality should be taken, including that:

1. the SEC and FINRA should clarify that brokers are required to seek best available prices (not just the best available “protected quotation”);<sup>3</sup>
2. the SEC and FINRA should clarify that brokers should conduct order-by-order routing decisions and reviews of execution quality;<sup>4</sup>
3. the SEC should revise Rule 605 so as to more accurately measure “price improvement,” including by measuring that against the best available prices, as opposed to the best available “protected quotation”; and

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<sup>1</sup> Under regulation NMS, exchange “take” fees are capped at 30 cents per 100 shares, and many venues currently charge that.

<sup>2</sup> But see, FINRA, Notice to Members 15-46, Nov. 2015, *available at* [https://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Notice\\_Regulatory\\_15-46.pdf](https://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-46.pdf) (“FINRA NTM 15-46”) (explaining that brokers’ best execution analysis should also evaluate available executions at venues to which they don’t currently route); see also, FINRA, Regulatory Notice 21-23, June 2021, *available at* <https://www.finra.org/sites/default/files/2021-06/Regulatory-Notice-21-23.pdf>, (June 2021 Notice).

<sup>3</sup> We welcome FINRA’s recent declaration that “when a firm is routing order flow for automated execution, or internally executing such order flow on an automated basis, the SEC has indicated that simply obtaining the best bid or best offer may not satisfy a firm’s best execution obligation, particularly with respect to small orders. In addition, FINRA cautioned that member firms would not satisfy their duty of best execution if they do not compare the execution quality they receive under their existing order routing and execution arrangements (including the internalization of order flow) to the quality of the executions they could obtain from competing markets.” June 2021 Notice.

<sup>4</sup> More than five years ago, FINRA acknowledged that order-by-order analysis and review was increasingly possible. FINRA NTM 15-46 (“FINRA believes that, given developments in order routing technology, order-by-order review of execution quality is increasingly possible for a range of orders in all equity securities and standardized options.”). Notably, since that time, many institutional investors with even very large orders have demanded and received analyses of execution quality at the child-order level, which are often in size increments that are akin to “retail” orders. We question why institutional brokers are often expected to provide this level of service, but retail brokers are not. Additional guidance by FINRA may be appropriate.

4. the SEC should revise Rule 606 to empower investors with more information regarding how their orders are routed to execution and explicit and implicit costs of their executions.

These reforms are essential compliments to a prohibition on conflicted order routing incentives for both off and on exchange trades, as they would directly ensure that brokers are truly looking after their customers' best interests, and not their own bottom lines.

Thank you for the opportunity to offer our insights into this important legislation.

Please feel free to have your staff contact Tyler Gellasch at the Healthy Markets Association at (202) 909-6138 or Barbara Roper at Consumer Federation of America at (719) 569-9159.

Sincerely,

Healthy Markets Association

Consumer Federation of America

Public Citizen

Consumer Action

Americans for Financial Reform