Federal Enforcement Forum: EXAMS -- Implementing Reg NMS Rule 606

*Rule 606:*EXAMS – the Division of Examinations – published a Risk Alert on November 10, 2022, providing its Observations Related to Regulation NMS Rule 606 Disclosures[1]. That Rule requires broker-dealers to provide enhanced disclosures about the handling of customer orders. Specifically, it was designed to provide better insight into factors that may influence routing decisions. The observations of the Division are divided into three segments in the Alert: 1) Issues with quantifiable disclosures; 2) issues with material aspect disclosures; and 3) supervision.

Initially, the Alert focus on quantifiable disclosures.The points here discuss the manner in which firms identified venues, classified orders and calculated aggregate net rebates in Rule 606(a)(1) reports.The deficiencies observed included:

1. Routing all orders to a clearing firm without creating a Rule 606 report or incorporating by reference the clearing firm's report;
2. Improperly identifying routing firms rather than the venues;
3. Inaccurately classifying order percentages among the four order type categories;
4. Disclosing inaccurate amounts of net aggregate rebates received for the four types of orders; and
5. Using incorrect data for determining inclusion of a stock in the S&P index.

Second, EXAMS observed firms that failed to disclose material aspects of their relationship with the routing broker or execution venue as required. In this regard the staff observed deficiencies about disclosures:

1. Concerning payment for order flow or PFOF arrangements with non-exchange venues and not disclosing the specific share of the rebate applicable to different order types;
2. Not disclosing that the firm had arrangements or that it provided attestations to venues to route retail orders;
3. Not disclosing that the firm had rebate arrangements or a rebate split with a venue;
4. Firms had discussions with its execution venues regarding increases or decreases but failed to make the appropriate disclosures;

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5. When adding new venues firms failed to disclosure material aspects of the arrangement; and;
6. Not disclosing material aspects of their PFOF arrangements with the firms.

The Alert concludes with observations regarding supervision.Specifically, EXAMS focused on FINRA Rule 3110(b)(1) and its requirement to establish and enforce an adequate system of supervision and controls.EXAMS concluded that firms had inadequate supervision regarding the accuracy and implementation of material aspects of Rule 606(a).

Overall, the Alert provides a guide to meeting the enhanced disclosure requirements of the Rule as well as ensuring that the firm meets its compliance obligations. In essence the Alert gives broker-dealers a clear guide for installing the new disclosure requirements and ensuring that its compliance systems and procedures are properly implemented.

[1] Observations Related to Regulation NMS Rule 606 Disclosures