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SEC Adopts Significant Changes to Reg ATS: Part 1 of 2

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T*his article will appear in two parts. Part 1 is set forth below, and Part 2 will be published in the January 2019 issue.*

On July 18, 2018, the Securities and Exchange Commission (SEC) voted unanimously to adopt significant amendments to Regulation ATS (Reg ATS).¹ The amendments, which impose heightened public disclosure requirements on alternative trading systems (ATSs) that trade national market system stocks (NMS Stock ATSs), are designed to enhance operational transparency, expand the SEC's oversight, and limit potential conflicts of interest relating to these trading venues.

Under the amended rules, NMS Stock ATSs must comply with the heightened disclosure requirements of new Form ATS-N starting January 7, 2019. All NMS Stock ATSs currently operating under a previously filed Form ATS must file a Form ATS-N by February 8, 2019, but no earlier than January 7, 2019.

As a practical matter, the implementation of Form ATS-N will result in additional information about the operation of NMS Stock ATSs becoming available to the investing public. While many ATSs currently make their Forms ATS public, since this is not a requirement of the current regime, the type of available information varies. The implementation

of Form ATS-N not only will require that the Form be made publicly available but also will require specific information to be made available including, for example, information about potential conflicts of information between an ATS operator and its affiliates and information about the types of subscribers in an NMS Stock ATS. The increased operational transparency should assist asset managers, retail broker-dealers, and others in making routing determinations.

Executive Summary

The recently adopted amendments to Reg ATS and newly adopted Form ATS-N will impose significantly greater regulatory obligations on NMS Stock ATSs. Key changes include the following:

- NMS Stock ATSs must file a Form ATS-N.
- Form ATS-N must be reviewed by the SEC and becomes effective either through the lapse of a set period of time without SEC action or through affirmative SEC publication of the Form ATS-N, if earlier. This is a significant difference from the notice filing requirement for ATSs under the prior version of Reg ATS.
- In determining whether it is “necessary or appropriate in the public interest, and is consistent

with the protection of investors” to declare a Form ATS-N ineffective, the SEC’s review will focus on “the completeness and comprehensibility of the Form ATS-N disclosures and [will] not include a review of the merits of the disclosures or whether such trading functionalities meet industry norms.”

- The SEC will review a Form ATS-N amendment for ineffectiveness using the same standard used for its review of an initial Form ATS-N; it will not weigh the merits of a change but will instead focus on the completeness and comprehensibility of the disclosures themselves. Amendments become effective 30 days after filing unless declared ineffective by the SEC.
- Part II of Form ATS-N is designed to inform subscribers and market participants about possible conflicts of interest for the broker-dealer operator and its affiliates or the potential leakage of subscribers’ confidential trading information. It requires detailed discussions about the interaction of orders with an NMS Stock ATS operator and its affiliates, arrangements between an NMS Stock ATS operator and unaffiliated trading centers to access an NMS Stock ATS or its services, products, and services offered to subscribers, and the activities of NMS Stock ATS service providers.
- Part III of Form ATS-N substantially enhances disclosures required with respect to the manner of operation of an NMS Stock ATS. Such disclosures include, for example, information related to the types of subscribers, eligibility for and exclusions from ATS services, means of order entry, connectivity and co-location, order types and sizes, conditional orders and indications of interest, liquidity providers, order segmentation, counterparty restrictions, fair access, and market data.
- Among other NMS Stock ATS filings, the SEC will make initial and amended Forms ATS-N public by posting them on its website (via EDGAR).

Each of these topics is discussed in more detail below.

Background

Originally adopted in 1998, Reg ATS established a new regulatory framework allowing then-fledgling trading systems that met the definition of an “exchange” but did not regulate the activities of their users as a general matter to choose to be regulated as broker-dealers subject to the new regulatory scheme rather than as national securities exchanges.² Over the past two decades, the equity markets and the significance of ATSs have evolved dramatically, and, driven by advances in technology, ATS operations have grown increasingly complex. Nevertheless, as the SEC noted when it proposed these amendments in 2015, the regulatory requirements applicable to ATSs generally have remained the same.³

The Proposing Release set forth an enhanced regulatory and oversight framework for these venues. Specifically, the SEC proposed to:

- adopt Form ATS-N, requiring detailed disclosures about the manner of operation of an NMS Stock ATS, the broker-dealer operator of the NMS Stock ATS, and the activities of such broker-dealer operator and its affiliates in connection with the NMS Stock ATS;
- make Form ATS-N publicly available on the websites of the SEC and the NMS Stock ATS;
- establish a process for the SEC to review Form ATS-N filings and to declare such filings effective or ineffective; and
- require that all ATSs adopt and maintain written safeguards and procedures to protect subscribers’ confidential trading information.

The SEC received 32 comment letters on the Proposing Release from industry trade associations, ATSs, broker-dealers, exchanges, institutional investors, and other market participants on a broad range of topics. Some commenters expressed concerns regarding the scope of the required disclosures,

while others urged the SEC to adopt additional disclosure items. Several commenters urged the SEC to provide more clarity and guidance regarding how it would evaluate Form ATS-N filings and amendments. Some commenters encouraged the SEC to extend proposed Rule 304, including Form ATS-N, to include fixed income ATSs.

Ultimately, the SEC adopted a rule very similar to the one described in the Proposing Release. In response to the submitted comments and concerns, the SEC:

- eliminated the requirement that it affirmatively declare Forms ATS-N to be effective;
- revised questions on Form ATS-N to add more “yes” or “no” prompts and more tailored, direct questions in an attempt to simplify the form and clarify expectations as to the types of expected answers;
- removed certain questions from Form ATS-N that would have required disclosure of commercially sensitive information; and
- clarified the process for NMS Stock ATSs to amend Form ATS-N.

Set forth below is a detailed description of the amendments.

Amendments to Reg ATS and Rule 3a1-1

The SEC amended or added the following rules to implement the Form ATS-N filing and review processes: (1) Rule 3a1-1(a), exempting entities, now including NMS Stock ATSs, that meet certain conditions from the definition of “exchange” under the Securities Exchange Act of 1934 (Exchange Act) and the corresponding registration requirements; (2) Rule 300(k) of Reg ATS, defining NMS Stock ATS; (3) Rule 301(a)(5), regarding exemptions from compliance with Reg ATS; (4) Rule 301(b)(2), regarding the filing of Forms ATS; (5) Rule 301(b)(9), regarding the filing of Forms ATS-R; (6) Rule 303, regarding ATS recordkeeping requirements; and (7) Rule

304, regarding the filing of, and effectiveness review for, Form ATS-N.⁴

Amended Exchange Act Rule 3a1-1(a) and Reg ATS, Rule 300—Definition of NMS Stock ATS, Exemption from Exchange Registration for NMS Stock ATSs

Rule 300(k) of Reg ATS was adopted to define an NMS Stock ATS as an ATS⁵ “that trades NMS stocks.”⁶ Under Section 5 of the Exchange Act, an entity that meets the definition of “exchange” under Section 3(a)(1) is generally required to register as an exchange. However, Rule 3a1-1(a) historically exempted from the definition of “exchange,” and therefore from the exchange registration requirements, any system that is (1) operated by a national securities association, (2) in compliance with Rules 300 to 303 of Reg ATS, or (3) not required to comply with Rules 300 to 303 of Reg ATS pursuant to Rule 301(a) of Reg ATS.⁷

The SEC amended Rule 3a1-1(a)(2)–(3) to refer to new Rule 304 of Reg ATS instead of Rule 303. Accordingly, for an ATS to be exempt from the definition of “exchange” and the corresponding registration requirements, it must comply with Rules 300 to 304 of Reg ATS or not be required to comply with those rules pursuant to Rule 301(a).

Collectively, these Rules impose enhanced disclosure requirements for ATSs that trade NMS stocks,⁸ which the SEC believes will promote efficient and effective markets.⁹ The enhanced disclosures are designed to (1) help brokers satisfy best execution obligations to customers by providing more information with which to assess trading venues;¹⁰ (2) help all market participants make more informed decisions about how to achieve trading and investment objectives, enhance execution quality, and improve efficiency and capital allocation;¹¹ and (3) equalize the availability of information about NMS Stock ATSs relative to national securities exchanges.¹² In approving these amendments, the SEC noted that “[n] early all commenters agree with our stated goal

of enhancing operational transparency for NMS Stock ATSs.”¹³

New Rule 304(a)(1) of Reg ATS—Filing and SEC Review of Initial Form ATS-N

New Rule 304(a)(1) sets forth the process by which Form ATS-N will be filed, reviewed by the SEC, and either become effective (such that the NMS Stock ATS may operate pursuant to the Rule 3a1-1(a) exemption from exchange registration) or be declared ineffective (such that the NMS Stock ATS may not operate pursuant to the exemption and must refile a new Form ATS-N or register as a national securities exchange or seek another exemption to exchange registration).

Form ATS-N Filing Process and SEC Review Period for New NMS Stock ATSs

For NMS Stock ATSs that seek to begin operating after January 7, 2019 (new NMS Stock ATSs), Rule 304(a)(1)(i) requires filing with the SEC an initial Form ATS-N and for that Form ATS-N to become “effective.” Only after the Form ATS-N becomes effective may the new NMS Stock ATS begin operating.¹⁴

NMS Stock ATSs must file Form ATS-N—including amendments to Form ATS-N as described below—via EDGAR.¹⁵ Once an NMS Stock ATS has filed its initial Form ATS-N, the SEC has 120 days from the date of filing to complete its review.¹⁶ The SEC may extend the review period (1) by 90 days, upon written notice by the SEC to the NMS Stock ATS, in the case of a Form ATS-N that “is unusually lengthy or raises novel or complex issues that require additional time for review”¹⁷ or (2) for any period of time to which an authorized representative of the NMS Stock ATS agrees in writing.¹⁸

An initial Form ATS-N becomes effective upon the earlier of (1) the completion of the SEC’s review and publication of Form ATS-N¹⁹ or (2) the expiration of the review period (including any extensions, if applicable).²⁰ The Proposing Release contemplated

the SEC’s being required to declare effective or ineffective an initial Form ATS-N after the applicable review period. As adopted, however, the SEC is not required to declare a Form ATS-N effective. As long as the Form ATS-N is not declared ineffective during the review period, the Form ATS-N automatically becomes effective at the expiration of the review period or the SEC can publish the Form ATS-N early if it completes its review before the expiration of the review period.²¹

The SEC, by order, will declare a Form ATS-N ineffective “if it finds, after notice and opportunity for hearing, that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors.”²² The standard by which the SEC conducts its review for ineffectiveness is described *infra*.

Form ATS-N Filing Process and SEC Review Period for Legacy NMS Stock ATSs

Under Rule 301(b)(2)(viii), a Legacy NMS Stock ATS is an NMS Stock ATS “that is operating pursuant to an initial operation report on Form ATS on file with the SEC as of January 7, 2019.” Rule 304(a)(1)(iv)(A) requires Legacy NMS Stock ATSs to file an initial form ATS-N between January 7, 2019, and February 8, 2019 (inclusive). Unlike a new NMS Stock ATS, a Legacy NMS Stock ATS will operate pursuant to the Rule 3a1-1(a) exemption on a provisional basis pursuant to its filed initial Form ATS-N, which supersedes and replaces the entity’s previously filed Form ATS.²³

Once a Legacy NMS Stock ATS has filed its initial Form ATS-N, the SEC has 120 days from the date of filing to review it.²⁴ As is the case for new NMS Stock ATSs, the SEC has the ability to extend the review period. The SEC may extend the review period (1) by 120 days (as compared with the 90-day period for new NMS Stock ATSs) upon written notice by the SEC to the NMS Stock ATS, in the case of a Form ATS-N that “is unusually lengthy or raises novel or complex issues that require additional time for review,”²⁵ or (2) for any period of time to

which an authorized representative of the NMS Stock ATS agrees in writing.²⁶

As is the case for new NMS Stock ATSs, an initial Form ATS-N filed by a Legacy NMS Stock ATS is effective as of the earlier of (1) the completion of review by the SEC and publication of Form ATS-N²⁷ or (2) the expiration of the review period (including any extensions, if applicable).²⁸

The same procedure (notice and opportunity for hearing) and standard (“necessary or appropriate in the public interest, and is consistent with the protection of investors”) as used to declare ineffective Forms ATS-N of new NMS Stock ATSs will apply to Forms ATS-N of Legacy NMS Stock ATSs.²⁹ If the SEC declares the Form ATS-N ineffective, the Legacy NMS Stock ATS would be ineligible for the Rule 3a1-1(a) exemption and would be required to cease operations.³⁰

Standard for SEC Review for Ineffectiveness of Form ATS-N

In determining whether it is “necessary or appropriate in the public interest, and is consistent with the protection of investors” to declare a Form ATS-N ineffective, the SEC’s review will focus on “the completeness and comprehensibility of the Form ATS-N disclosures and [will] not include a review of the merits of the disclosures or whether such trading functionalities meet industry norms.”³¹

The Adopting Release provides three examples that would result in the SEC’s declaring a Form ATS-N ineffective, after notice and opportunity for hearing:³²

- *The Form ATS-N was filed by an entity that does not meet the definition of an NMS Stock ATS.* Because the classification of an entity signals to market participants the functions performed by that entity and the regulatory framework that governs it, SEC review to ensure that an entity is correctly classified as an NMS Stock ATS “will help mitigate concerns that market participants may be confused or misled about whether an

entity in fact meets the definition of an NMS Stock ATS.”³³

- *One or more disclosures reveal noncompliance with federal securities laws, or the rules or regulations thereunder, including Reg ATS.* The SEC will conduct a “red flag” review for instances of non-compliance with federal securities laws that seem apparent from the disclosures on the Form ATS-N. The SEC provided two examples of potential red flags in a Form ATS-N:³⁴
 1. If an NMS Stock ATS filed a Form ATS-N before becoming registered as a broker-dealer and becoming a member of a self-regulatory organization (SRO), it would not be in compliance with Section 15 of the Exchange Act or Rule 301(b)(1) of Reg ATS.
 2. If a Form ATS-N indicated that the NMS Stock ATS would accept orders or indications of interest in sub-penny increments, it would not be in compliance with Rule 612 of Regulation NMS.
- *One or more disclosures on Form ATS-N are materially deficient with respect to their completeness or comprehensibility.* This is a facts-and-circumstances review that “will focus on whether the lack of completeness or comprehensibility in a Form ATS-N disclosure would prevent market participants from understanding an ATS’s operations or the ATS-related activities of its broker-dealer operator or its affiliates.”³⁵ The Adopting Release contained several non-exhaustive examples of disclosures that would be considered materially deficient with respect to their completeness³⁶ or comprehensibility.³⁷

The SEC does not intend to engage in merit-based reviews of Forms ATS-N.³⁸ Examples of a merits-based review include (1) evaluating the strengths and weaknesses of the NMS Stock ATS’s trading platform or protocols;³⁹ (2) making findings regarding whether the means by which orders will interact on the trading platform are consistent with securities laws;⁴⁰ (3) comparing the NMS Stock ATS’s services

against industry norms;⁴¹ and (4) approving or disapproving operational aspects of an NMS Stock ATS, such as a new trading functionality, order type, or execution protocol.⁴²

The SEC anticipates that, prior to declaring a Legacy NMS Stock ATS's Form ATS-N ineffective (requiring the Legacy NMS Stock ATS to cease operating pursuant to the Rule 3a1-1(a) exemption), it will have a dialogue with the Legacy NMS Stock ATS that will allow the Legacy NMS Stock ATS to address perceived deficiencies via amendments during the SEC review period and thereby avoid a declaration of ineffectiveness.⁴³ The Legacy NMS Stock ATS could also consent to an extended SEC review period in order to have more time to address deficiencies in its Form ATS-N.⁴⁴ If a Form ATS-N is declared ineffective, the Legacy NMS Stock ATS can

file a new Form ATS-N, which the SEC will review without prejudice.⁴⁵

New Rule 304(a)(2) of Reg ATS— Amending Form ATS-N

NMS Stock ATSs must keep their filed Forms ATS-N up to date. This is, at a high level, accomplished by filing new forms that contain one of four types of amendments: (1) Material Amendments, (2) Updating Amendments, (3) Correcting Amendments, and (4) Order Display and Fair Access Amendments. The following sections describe in greater detail the processes for amending (1) an effective Form ATS-N, (2) an initial Form ATS-N that has been filed but is not yet effective, and (3) a Material Amendment that has been filed but that is not yet effective.⁴⁶

Type of Amendment	Material Amendment	Updating Amendment	Correcting Amendment	Order Display and Fair Access Amendment
Rule	304(a)(2)(i)(A)	304(a)(2)(i)(B)	304(a)(2)(i)(C)	304(a)(2)(i)(D)
Circumstances that Require Amendment	Material change to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates (except a material change covered by Order Display and Fair Access Amendment)	Information on Form ATS-N has become inaccurate or incomplete and was not required to be reported as one of the other three types of amendments ⁴⁸	Discovery that information previously filed on a Form ATS-N was materially inaccurate or incomplete when filed	Information required to be disclosed in Part III, Items 24 and 25 of Form ATS-N has become inaccurate or incomplete ⁴⁹
When to File Amendment	At least 30 calendar days prior to the date of implementation of the material change ⁵⁰	No later than 30 calendar days after the end of each calendar quarter	Promptly after discovery; “promptly” generally means five business days after discovery ⁵¹	No later than 7 calendar days after the information has become inaccurate or incomplete
Public Disclosure (Rule 304(b)(2) (iii))	Cover page to be made public upon filing; entirety to be made public upon expiration of review period, unless declared ineffective ⁵²	Made public upon filing ⁵³	Made public upon filing	Made public upon filing

Amendments to an Effective Form ATS-N

For each of the four categories of amendments, the following table summarizes (1) when the particular amendment is required, (2) when it must be filed, and (3) the timeline on which the amendment is made public. The categories are mutually exclusive; when an NMS Stock ATS files an amendment, it must specify the single category under which the amendment falls.⁴⁷

SEC Review. The SEC will review a Form ATS-N amendment for ineffectiveness using the same standard as for its review of an initial Form ATS-N; it will not weigh the merits of a change but will instead focus on the completeness and comprehensibility of the disclosures themselves.⁵⁴ Pursuant to Rule 304(a)(2)(ii), a Form ATS-N amendment will be deemed effective no later than 30 days after filing unless the SEC declares the form ineffective. An NMS Stock ATS will not be allowed to continue to operate pursuant to an ineffective Form ATS-N amendment. Rather, it would operate pursuant to the Form ATS-N that was previously declared effective (without the changes that were the subject of the amendment). The NMS Stock ATS could then file a new Form ATS-N amendment in an attempt to resolve the deficiency that caused the first amendment to be declared ineffective.

Definition of “Material.” As indicated in the Proposing Release, the SEC will consider a change to be “material” for the purposes of Material and Correcting Amendments “if there is a substantial likelihood that a reasonable market participant would consider the change important when evaluating the NMS Stock ATS as a potential trading venue.”⁵⁵ The SEC received a number of comments seeking clarification on the types of changes that the SEC would consider “material.”⁵⁶ Commenters expressed concern that a materiality standard could be subjective and that good-faith decisions that a change is not material could be second-guessed or that the SEC could regard every change as material.⁵⁷ Commenters also suggested that certain categories of changes,

like non-subscriber-facing changes to software, hardware, or other trading infrastructure, could be considered not material.⁵⁸ In the Adopting Release, the SEC adopted the same definition of materiality as in the Proposing Release and provided the same non-exhaustive list of examples of “scenarios that are particularly likely to implicate a material change”:⁵⁹

- a broker-dealer operator or its affiliates beginning to trade on the NMS Stock ATS;
- a change to the broker-dealer operator’s policies and procedures governing the written safeguards and written procedures to protect the confidential trading information of subscribers pursuant to Rule 301(b)(10)(i) of Reg ATS;
- a change to the types of participants on the NMS Stock ATS;
- a change to the available order types (for example, the introduction or removal of an order type);
- a change to the order interaction and priority procedures;
- a change to the segmentation of orders and participants;
- a change to the manner in which the NMS Stock ATS displays orders or quotes;⁶⁰ or
- a change of a service provider to the operations of the NMS Stock ATS that has access to subscribers’ confidential trading information.

In general, in determining whether a change is material, NMS Stock ATSs should consider “whether such change would affect: (1) the competitive dynamics among ATS subscribers; (2) the execution quality or performance of the orders of any subscriber or category of subscribers; (3) the fees that any subscriber or category of subscribers would pay to access and/or use the ATS; (4) the nature or composition of counter-parties with which any subscriber or category of subscribers interact; and (5) the relative speed of access or execution of any subscriber or group of subscribers.”⁶¹ The SEC also encourages

NMS Stock ATSs to “generally consider whether the cumulative effect of a series of changes to the operations of the NMS Stock ATS or the activities of the broker-dealer operator or its affiliates with regard to the NMS Stock ATS is material.”⁶²

Amendments to an Initial Form ATS-N That Is Not Yet Effective

Under Rule 304(a)(1)(ii), during the SEC review period for an initial Form ATS-N, a new NMS Stock ATS must file any necessary Updating Amendments and Correcting Amendments as described in the table above. Rather than being published upon filing, however, these amendments will be published with the effective Form ATS-N. During the review period for an initial Form ATS-N, a new NMS Stock ATS will not file Material Amendments; instead, it will withdraw and refile its entire Form ATS-N.⁶³

The process for filing an amendment to an initial Form ATS-N for a Legacy NMS Stock ATS during the SEC review period is similar. A Legacy NMS Stock ATS must file any necessary amendments as described in the table above.⁶⁴ Updating, Correcting, and Order Display and Fair Access Amendments will be published with the effective Form ATS-N, not upon filing. Material Amendments will be published as of the later of publication of the effective Form ATS-N or the expiration of the SEC’s 30-day review period.⁶⁵

Regardless of when amendments are published, the SEC has until 30 days after filing (which may extend past the end of the review period for an initial Form ATS-N⁶⁶) to declare them ineffective.⁶⁷

Amendments to a Material Amendment That Is Not Yet Effective

Under Rule 304(a)(2)(ii), during the SEC review period for a Material Amendment, an NMS Stock ATS must file Updating and Correcting Amendments as described in the above table, and such amendments will become public with the publication of the Material Amendment. If the NMS

Stock ATS is required to file a subsequent Material Amendment, it must withdraw its first Material Amendment and file a new Form ATS-N containing the new Material Amendment.

New Rule 304(a)(3) of Reg ATS—Notice of Cessation of Operations

Under Rule 304(a)(3), an NMS Stock ATS shall provide notice that it will cease to operate as an NMS Stock ATS at least 10 business days prior to the date on which operations will cease. Form ATS-N will become ineffective on the date designated by the NMS Stock ATS in its notice.

New Rule 304(a)(4) of Reg ATS—Suspension, Limitation and Revocation of the Exemption From the Definition of Exchange

Under Rule 304(a)(4), the SEC will, by order— if it finds, after notice and opportunity for hearing, that such action is necessary or appropriate in the public interest and is consistent with the protection of investors—suspend for a period not exceeding 12 months, limit or revoke the exemption for an NMS Stock ATS pursuant to Rule 3a1-1. The NMS Stock ATS will then be prohibited from operating pursuant to the exemption (in the case of a suspension or revocation) or operating inconsistently with the SEC’s order (in the case of a limitation). Failing to abide by the terms of a revocation, suspension or limitation risks the NMS Stock ATS’s operating as an unregistered national securities exchange.⁶⁸

A determination whether to suspend, limit, or revoke an exemption will depend on the facts and circumstances.⁶⁹ A revocation would be appropriate “upon the existence of a problem involving the ATS that significantly impacts the public interest and the protection of investors.”⁷⁰ For example: an NMS Stock ATS no longer meets the definition of “NMS Stock ATS” or is no longer a registered broker-dealer;⁷¹ or if the NMS Stock ATS appears to be violating, or to have violated, the antifraud provisions

of the federal securities laws.⁷² A limitation would be appropriate if there are specific disclosures or activities that are the cause of the noncompliance with Reg ATS or that violate federal securities laws and it would be more in line with the public interest and protection of investors to limit the scope of an NMS Stock ATS's exemption.⁷³ For example: if an NMS Stock ATS implements a material change to its operations but fails to disclose the material change, the SEC might permit the ATS to continue operating as disclosed on its Form ATS-N but limit it from engaging in the undisclosed activity until its Form ATS-N is properly amended.⁷⁴

New Rule 304(b) and (c)—Public Disclosures

Under Rule 304(b)(1), each Form ATS-N constitutes a “report” within the meaning of sections 11A, 17(a), 18(a) and 32(a) of the Exchange Act. Accordingly, “it would be unlawful for any person to willfully or knowingly make, or cause to be made, a false or misleading statement with respect to any material fact in Form ATS-N.”⁷⁵ The SEC believed defining Form ATS-N as a “report” is important because “market participants will rely on these disclosures when making routing decisions or assessing their brokers’ routing practices” and it “will incentivize NMS Stock ATS operators to make truthful statements on Form ATS-N.”⁷⁶

Under Rule 304(b)(2), the SEC will make the following documents public by posting on its website (via EDGAR):⁷⁷ (1) an effective initial Form ATS-N; (2) an order of ineffective initial Form ATS-N; (3) an amendment to an effective Form ATS-N (*see above table*); (4) an order of ineffective Form ATS-N amendment; (5) a notice of cessation; and (6) an order suspending, limiting or revoking the exemption for an NMS Stock ATS from the definition of an “exchange” pursuant to Rule 3a1-1. The SEC stated that making these forms public is important to provide market participants with access to information that allows them to compare and contrast market centers.⁷⁸

Amended Rules 301 and 303 of Reg ATS—Exemption from Reg ATS; Filing Requirements; Recordkeeping

In addition to the primary amendments and new Rule 304 described above, the Adopting Release included amendments to existing Rules 301 and 303 of Reg ATS to accommodate Form ATS-N.

Rule 301(a)—Exemption from Reg ATS or Particular Requirements of Reg ATS

Rule 301(a) requires an ATS to comply with the requirements in Rule 301(b) (for example, registration as a broker-dealer, filing the requisite forms, making and preserving records under Rules 302 and 303) unless it is exempted from compliance under one of the enumerated exemptions. Rule 301(b) was amended (*see infra*) and Rule 304(a) was drafted such that Rule 301(a) exemptions would also exempt the ATS from compliance with Rule 304.

Rule 301(a)(5) permits the SEC, after application by an ATS, to exempt an ATS from one or more of the requirements of Rule 301(b) if the exemption is “consistent with the public interest, the protection of investors, and the removal of impediments to, and perfection of the mechanisms of, a national market system.” Rule 301(a)(5) was amended to permit the SEC to exempt an ATS from one or more of the requirements of Rule 301(b) or Rule 304.

Rule 301(b)(2) and 301(b)(9)—Filing Requirements

Rule 301(b)(2) sets forth requirements for filing Forms ATS, amendments and notices of cessation for ATSs. Under Rule 304(a), NMS Stock ATSs are exempted from the requirement to file a Form ATS under Rule 301(b)(2)(i)–(vii) (because such NMS Stock ATSs will be required to file a Form ATS-N).⁷⁹ A new subsection, Rule 301(b)(2)(viii), has been added and clarifies that an ATS that trades NMS stocks as well as securities other than NMS stocks is subject to Rule 304 with respect to NMS stocks and all of Rule 301(b) with respect to

non-NMS stocks.⁸⁰ In response to comments that maintaining both a Form ATS-N with respect to NMS stocks and a Form ATS with respect to non-NMS-stock securities would be burdensome, the SEC noted that (1) the Form ATS would be easier to maintain because it would no longer include information regarding NMS stocks; and (2) the Form ATS-N is tailored to NMS stocks, and allowing an ATS to include information regarding securities that are not NMS stocks on Form ATS-N likely would result in incomplete disclosures regarding those securities that are not NMS stocks.⁸¹

Rule 303—Recordkeeping

Rule 301(b)(8) requires ATSs to make and keep current the records specified in Rule 302 and to preserve the records specified in Rule 303. Rule 303(a)(2)(ii) was amended to require that an NMS Stock ATS preserve copies of any initial Form ATS-N, Form ATS-N amendment, and notice of cessation for the life of the enterprise and of any successor enterprise. Currently, ATSs are subject to the same record preservation requirements with respect to Form ATS reports.⁸²

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NOTES

- ¹ Regulation of NMS Stock Alternative Trading Systems, Exchange Act Release No. 83663 (July 18, 2018), 83 Fed. Reg. 38,768 (Aug. 7, 2018) (“Adopting Release”), available at <https://www.gpo.gov/fdsys/pkg/FR-2018-08-07/pdf/2018-15896.pdf>.
- ² Regulation of Exchanges and Alternative Trading Systems, Exchange Act Release No. 40760 (Dec. 8,

1998), 63 Fed. Reg. 70,844 (Dec. 22, 1998), available at <https://www.gpo.gov/fdsys/pkg/FR-1998-12-22/pdf/98-33299.pdf>.

- ³ Regulation of NMS Stock Alternative Trading Systems, Exchange Act Release No. 76474 (Nov. 18, 2015), 80 Fed. Reg. 80,998 (Dec. 28, 2015) (Proposing Release), available at <https://www.gpo.gov/fdsys/pkg/FR-2015-12-28/pdf/2015-29890.pdf>.
- ⁴ The SEC also made unrelated changes to Rule 301(b)(10) that require an ATS’s procedures and safeguards to protect subscribers’ confidential trading information and its related oversight procedures—which were already required under existing Reg ATS—to be reduced to writing. Adopting Release, *supra* n. 1, at 38,863–64. The new or modified Rules 300 to 304 will be codified with the existing provisions of Reg ATS at Title 17, Sections 242.300-304 of the Code of Federal Regulations.
- ⁵ Rule 300(a) of Reg ATS defines an “alternative trading system” generally as a system that brings together purchasers and sellers of securities (or otherwise performs the functions of a stock exchange) that does not also act as a self-regulatory organization.
- ⁶ For purposes of Reg ATS, “NMS stocks” generally include all exchange traded securities other than debt and convertible debt securities. *See* Reg ATS Rule 300(g).
- ⁷ Generally, Rule 301(a) provides that certain ATSs that are subject to other appropriate regulations are not required to comply with Regulation ATS. Specifically, an ATS is exempt if it is registered as a national securities exchange; is exempt from national securities exchange registration based on the limited volume of transactions effected; is operated by a national securities association; is registered as a broker-dealer under Sections 15(b) or 15C of the Exchange Act or is a bank, and limits its activities to certain instruments; or is exempted by SEC order after application by such ATS.
- ⁸ The SEC acknowledged receipt of comments supporting extending the new requirements to all ATSs; to ATSs that trade fixed income securities, including government securities; and/or to broker-dealers that

internalize order flow. Ultimately, the SEC determined to apply the new rules only to NMS Stock ATSs and to monitor the implementation of the rules and pursue expansion to other types of ATSs through a separate rulemaking process, if at all. *See* Adopting Release, *supra* n.1, at 38,783.

⁹ *See id.* at 38,780.

¹⁰ *See id.* at 38,778.

¹¹ *See id.*

¹² *See id.* at 38,781.

¹³ *Id.* at 38,777 n.108 and accompanying text.

¹⁴ *See id.* at 38,786.

¹⁵ *See id.* at 38,786 n.249.

¹⁶ *See id.* at 38,911 (to be codified at 17 CFR § 242.304(a)(1)(ii)). References to the adopted rules hereinafter will be referred to by the rule numbers they will have once codified, *e.g.*, Rule 304(a)(1)(ii).

¹⁷ *See* Rule 304(a)(1)(ii)(A)(1).

¹⁸ *See* Rule 304(a)(1)(ii)(A)(2).

¹⁹ *See* Rule 304(a)(1)(iii)(A)(1).

²⁰ *See* Rule 304(a)(1)(iii)(A)(2).

²¹ *See* Adopting Release, *supra* n.1, at 38,790.

²² Rule 304(a)(1)(iii)(B).

²³ This process was modified from the proposed rule, under which the NMS Stock ATS would have operated pursuant to its previously filed Form ATS until the SEC completed its review of the entity's initial Form ATS-N. This proposal would have required a firm to keep up to date both its Form ATS and its Form ATS-N during the SEC's review period, which would have been burdensome. *See* Adopting Release, *supra* n.1, at 38,798–99. The adopted Rule “is designed to facilitate an orderly transition for Legacy NMS Stock ATSs from the Form ATS regime to the Form ATS-N regime while at the same time requiring an appropriate level of disclosure by NMS Stock ATSs.” *See id.* at 38,799.

²⁴ *See* Rule 304(a)(1)(iv)(B).

²⁵ *See* Rule 304(a)(1)(iv)(B)(1).

²⁶ *See* Rule 304(a)(1)(iv)(B)(2).

²⁷ *See* Rule 304(a)(1)(iv)(A)(1).

²⁸ *See* Rule 304(a)(1)(iv)(A)(2).

²⁹ *See* Rule 304(a)(1)(iv)(B) and Rule 304(a)(1)(iii).

³⁰ *See* Adopting Release, *supra* n.1, at 38,795.

³¹ *Id.* at 38,782.

³² *See id.* at 38,795.

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.* at 38,796.

³⁶ *Id.* at 38,795–96.

³⁷ *Id.* at 38,796.

³⁸ The SEC considered whether requiring SEC review of a Form ATS-N would mislead market participants as to whether the SEC has approved the merits of a Form ATS-N or an NMS Stock ATS's operations. The SEC stated that it believed the scope of its review was clear and that the change from the Proposing Release to eliminate the need for affirmative SEC determination that the Form ATS-N is effective “will help signal to market participants that the SEC is not passing on the merits of the NMS Stock ATSs' disclosures regarding their operations.” *Id.* at 38,793.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.* at 38,797.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.* at 38,800.

⁴⁵ *Id.*

⁴⁶ *See* Rule 304(a)(2).

⁴⁷ Adopting Release, *supra* n.1, at 38,802 n.445 and accompanying text.

⁴⁸ As proposed, Updating Amendments would have covered only information that became “inaccurate.” In adopting the rule, the SEC added “incomplete” to ensure that “market participants have access to accurate, current, and complete disclosures on Form ATS-N.” Adopting Release, *supra* n.1, at 38,805. The Adopting Release provided one example of content appropriate for an Updating Amendment: “[I]f an NMS Stock ATS that publishes or otherwise provides to one or more subscribers or persons aggregate platform-wide order flow and execution statistics of the NMS Stock ATS that are not otherwise required disclosures under Rule 605 of Regulation NMS, the NMS Stock ATS could, depending on the facts and

circumstances, disclose changes to such statistics in a[n] [U]pdating [A]mendment. . . .” *Id.* at 38,805 n.494 and accompanying text.

⁴⁹ As proposed, amendments to these sections of Form ATS-N would have been considered Material Amendments. However, because an NMS Stock ATS would not necessarily be able to foresee when it would become subject to or exceed order display and execution or fair access thresholds, the 30-days-prior-to-implementation standard for Material Amendments would be impossible to adhere to. Accordingly, the SEC created a new category for Order Display and Fair Access Amendments and provided a different filing timeline in order to balance compliance with Rule 304 and providing market participants with timely notice of material changes. *Id.* at 38,804–05.

⁵⁰ Commenters suggested a carve-out, or exception, from the 30-day advance notice requirement in the case of exigent circumstances that would require an ATS operator to take “decisive action.” *Id.* at 38,785. The SEC noted that such situations could be addressed by Rule 301(a)(5) exemptions. The SEC also noted that an NMS Stock ATS might be able to avoid the need to apply for an exemption by including in its Form ATS-N backup plans for issues that it anticipates may arise. Adopting Release, *supra* n.1, at 38,785.

⁵¹ Adopting Release, *supra* n.1, at 38,806 n.498.

⁵² As proposed, Material Amendments would have been made public upon filing. In response to comments, the SEC determined to make only the cover page public to avoid being “confusing or misleading to the public, particularly in the event the material amendment is declared ineffective and the related change is never implemented.” Adopting Release, *supra* n.1, at 38,814. A cover page for a Material Amendment will (1) indicate that the NMS Stock ATS has filed a Material Amendment, (2) provide a brief narrative about the content of the amendment, (3) indicate the Part and Item number of Form ATS-N that is subject to change, and (4) state whether such change will apply to all subscribers and the broker-dealer operator.

⁵³ The SEC is making the remaining categories of amendments public upon filing because the

amendments reflect the *current* (not prospective, as in the case of a Material Amendment) operation of the NMS Stock ATS, so any risk of confusion of publishing an amendment that might later be declared ineffective is outweighed by market participants’ need for the updated information. *Id.* at 38,815.

⁵⁴ *Id.* at 38,806–07.

⁵⁵ *Id.* at 38,803, 38,806.

⁵⁶ *Id.* at 38,803–04.

⁵⁷ *See id.* at 38,803 nn.471–76.

⁵⁸ *See id.* at 38,803 n.470.

⁵⁹ *Id.* at 38,803.

⁶⁰ In response to a commenter, the SEC noted that “a change to the manner in which the NMS Stock ATS displays orders or trading interest, such as the font size in which orders are displayed, would not be a material change if there would not be a substantial likelihood that a reasonable market participant would consider the change important when evaluating the NMS Stock ATS as a potential trading venue.” *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ Rule 304(a)(1)(ii). Withdrawing and refile Form ATS-N restarts the 120-day SEC review period.

⁶⁴ Rule 304(a)(1)(iv)(C).

⁶⁵ Adopting Release, *supra* n.1, at 38,812 n.564.

⁶⁶ *Id.* at 38,794 n.366, 38,801.

⁶⁷ Rule 304(a)(2)(ii).

⁶⁸ Adopting Release, *supra* n.1, at 38,809.

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.* at 38,809 n.534.

⁷⁵ *Id.* at 38,810 & n.545.

⁷⁶ *Id.* at 38,810–11.

⁷⁷ Each NMS Stock ATS must also post, on its website, a link to these documents on the SEC website. Rule 304(b)(3).

⁷⁸ Adopting Release, *supra* n.1, at 38,811.

⁷⁹ A Legacy NMS Stock ATS must comply with Rule 301(b)(2)(i)–(vii) until it files an initial Form ATS-N

with the SEC, after which it is subject to the filing and reporting requirements of Rule 304.

- ⁸⁰ Conforming amendments were made to Rule 301(b)(9)—ATSs must report transaction volume on Form ATS-R separately for NMS stocks and for non-NMS stocks. *Id.* at 38,787. The SEC acknowledged that FINRA's website already provides some volume information for ATSs that trade NMS stocks, but stated that Form ATS-R provides information that is unavailable on the FINRA website and therefore continues to help the SEC oversee and monitor

the trading activity of NMS Stock ATSs. *Id.* Forms ATS-R will be confidential. *Id.* at 38,787 n.256.

- ⁸¹ *Id.* at 38,785–86.

- ⁸² The SEC also adopted a correcting amendment to Rule 303(a), which previously stated that, to comply with the condition set forth in paragraph (b)(9) of Rule 301, an ATS needed to preserve the enumerated records. Paragraph (b)(9) related to reporting, not recordkeeping, and the SEC took this opportunity to change the reference to the correct paragraph, (b)(8).

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