
SEC Proposes Significant Regulatory Changes for Alternative Trading Systems

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On November 18, 2015, the Securities and Exchange Commission (“SEC” or “Commission”) proposed significant changes to the regulatory requirements applicable to dark pools and other alternative trading systems (“ATSs”) that trade national market system stocks (“NMS Stock ATSs”). As a general matter, the proposed changes to Regulation ATS (“Reg ATS”), promulgated under the Securities Exchange Act of 1934 (“Exchange Act”), are designed to: (1) provide detailed public information to market participants about the potential conflicts of interest and operations of NMS Stock ATSs, their broker-dealer operators and the affiliates of their broker-dealer operators to allow such market participants to better determine where to send their orders; (2) provide more information to the SEC so it may more effectively regulate NMS Stock ATSs; and (3) adjust the regulatory obligations applicable to competing ATSs and national securities exchanges.

As the SEC noted in the Proposing Release, in the 17 years since the adoption of Reg ATS, the equity market structure and the role of ATSs have evolved significantly. The number of NMS Stock ATSs (now 46), as well as the trading volume on those ATSs (now 15% of total share trading volume) has increased greatly. NMS Stock ATSs increasingly are operated by multi-service broker-dealers engaged in significant brokerage and dealer activities in addition to the operation of their NMS Stock ATSs. This has led to NMS Stock ATSs becoming increasingly intertwined with the other activities of their operating broker-dealers and their affiliates, giving rise to potential conflicts of interest among the various business interests of each entity. NMS Stock ATSs also have grown increasingly complex in terms of the services and functionalities they offer subscribers (*e.g.*, order types, means of access such as via smart order routers (“SORs”) and algorithms, customized trading parameters). The SEC is concerned that despite NMS Stock ATSs acting as a significant source of liquidity in today’s markets, there is limited information available to market participants about the operations of ATSs and the activities of their broker-dealer operators and their affiliates. As a result, the SEC proposes to:

- Adopt Form ATS-N, which would require an NMS Stock ATS to provide, among other things, detailed information about the: (1) manner of operation of the NMS Stock ATS; and (2) 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
- Adopt new Rule 304 of Reg ATS, which would provide a process for the SEC to determine whether an entity qualifies for the exemption from the definition of “exchange” pursuant to Exchange Act Rule 3a1-1(a)(2) regarding NMS stocks and declare an NMS Stock ATS's Form ATS-N either effective or, after notice and opportunity for hearing, ineffective; and
- Amend Exchange Act Rule 301(b)(10) of Reg ATS to require that all ATSs (not just NMS Stock ATSs) put their safeguards and procedures for protecting subscribers' confidential trading information in writing.

The SEC believes that the proposed enhanced transparency requirements would benefit a wide range of market participants that rely on NMS Stock ATSs for their trading needs. For example, the proposal would aid broker-dealer subscribers that route customer orders to NMS Stock ATSs in meeting their best execution obligations to their customers as they will be able to better assess the trading venues to which they route orders. Similarly, institutional investors that route orders to an NMS Stock ATS directly or via their brokers would have more information regarding the operation of an NMS Stock ATS and its competitors, including how customer orders are matched and executed. Nevertheless, the regulatory framework proposed by the Commission warrants close scrutiny by all market participants, including the following:

- **ATSs/Broker-Dealer Operators.** ATSs and their broker-dealer operators will want to review the proposals to weigh the costs and benefits as applied to them. Among other things, such entities will have to carefully assess whether the enhanced disclosures and oversight, and the associated regulatory and business costs, are consistent with their business models.
- **Exchanges.** The SEC's proposal attempts to level the playing field between exchanges and ATSs, at least in part. Exchanges will need to evaluate whether the Commission's approach achieves an appropriate level of parity.
- **Institutional Investors.** Institutional investors and other users of ATSs will need to evaluate whether ATSs will still be able to meet their business needs in an environment of enhanced disclosure and oversight.

A detailed description of key aspects of the SEC's proposal is provided below. The SEC requested comment on the proposal by February 26, 2016.

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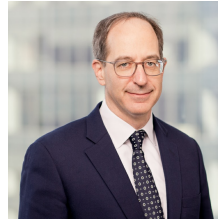
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