

**INFORMATIONAL**

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## **Exchange Act Rule 11Ac1-5**

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### **Member Obligations To Provide Statistical Information About Order Executions Under Rule 11Ac1-5 of the Securities Exchange Act of 1934**

**SUGGESTED ROUTING**

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Executive Representatives
- Legal & Compliance
- Operations
- Senior Management

**KEY TOPICS**

- Exchange Act Rule 11Ac1-5
- Disclosure of Order Execution

### **Executive Summary**

On November 17, 2000, the Securities and Exchange Commission (SEC) adopted Exchange Act Rule 11Ac1-5 ("Rule"), which requires "market centers" that trade national market system securities to make available standardized, monthly reports containing statistical information about "covered order" executions. The Rule is intended to promote visibility and competition in order execution quality, particularly with respect to execution price and speed.

The Rule defines a market center as "any exchange market maker, OTC market maker, alternative trading system, national securities exchange, or national securities association." In order to establish uniform reporting procedures between market centers, the Rule directs national securities exchanges and the National Association of Securities Dealers, Inc. (NASD®) to submit for approval by the SEC a joint national market system plan. The plan must be submitted no later than February 15, 2001. A proposed plan (Attachment A) has been drafted, but has not yet been submitted to the SEC for approval. As further detailed in this *Notice*, the first phase-in of securities subject to the Rule will begin on April 2, 2001.

### **Questions/Further Information**

Questions concerning this *Notice* may be directed to Kathleen O'Mara, Assistant General Counsel, or Philip Shaikun, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8071.

### **Background and Information**

In an effort to increase visibility

of execution quality and promote competition in the securities markets, the SEC on November 17, 2000 adopted Exchange Act Rules 11Ac1-5 (Attachment B) and 11Ac1-6.<sup>1</sup> Generally, the rules seek to improve the ability of public investors to monitor orders after they are submitted to a broker/dealer for execution. Rule 11Ac1-5 requires "market centers" to prepare and make publicly available monthly reports in electronic form that categorize order executions and include statistical data about execution quality. The Rule defines a market center as "any exchange market maker, OTC market maker, alternative trading system, national securities exchange, or national securities association." The Rule requires market centers to prepare reports on "covered orders" in national market system securities that it receives from any person.<sup>2</sup> A covered order is defined in the Rule as

any market order or any limit order (including immediate-or-cancel orders) received by a market center during regular trading hours at a time when a consolidated best bid and offer is being disseminated, and, if executed, is executed during regular trading hours, but shall exclude any order for which the customer requests special handling for execution, including, but not limited to, orders to be executed at a market opening or closing price, orders submitted with stop prices, orders to be executed only at their full size, orders to be executed on a particular type of tick or bid, orders submitted on a "not held" basis, orders for other than regular settlement, and orders to be executed at prices unrelated to the market price at the time of execution.

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To facilitate cross-market comparisons, the Rule establishes and defines uniform measures of execution quality, among them effective spread, rate of price improvement and disimprovement, fill rate, and execution speed.<sup>3</sup>

The Rule requires the market center reports to be categorized by individual security, order type, and order size. The Rule sets forth five order types (market, marketable limit, inside-the-quote limit, at-the-quote limit, and near-the-quote limit) and four order sizes (100-499 shares, 500-1999, 2000-4999, and 5000 or more). For each of the categories, the Rule further requires specific columns of statistical information related to execution quality. Members should refer directly to the Rule for the specific information required. The text of the Rule can be found in Attachment B of this *Notice*.

The Rule also directs the self-regulatory organizations (SROs) to submit a joint plan to the SEC that sets forth procedures and standards for market centers to produce publicly available monthly reports in a readily accessible, uniform, and usable electronic format. The plan must be submitted to the SEC by February 15, 2001. View Attachment A to this Notice for the text of the currently proposed plan. However, members should be advised that the plan

could change before it is submitted to the SEC. Moreover, the SEC has indicated that it will publish the plan for notice and comment before final approval. We anticipate that the plan will receive final SEC approval prior to the compliance date of April 2, 2001.<sup>4</sup>

The proposed plan obligates each market center to make its files available for downloading on an Internet site. Each market center must notify its "designated participant" – either a national securities exchange or the NASD – of a hyperlink to the Internet site where its files can be found and downloaded. Each designated participant is further required to maintain an Internet site where links to files for all of its responsible market centers can be accessed. An entity that acts as a market maker in different trading venues (*e.g.*, as a specialist on an exchange and as an over-the-counter (OTC) market maker) will be considered a separate market center for each of those trading venues. As such, the entity should arrange for a separate designated participant for each market center/ trading venue (*e.g.*, an exchange for its specialist trading and an association for its OTC trading).

### Effective Dates

The first phase-in of securities subject to the Rule will begin on Monday, April 2, 2001. As of that date, the Rule will apply to the 1000 NYSE securities, 1000 Nasdaq securities, and 200 Amex securities with the highest average daily share volume for the quarter ended December 31, 2000. A list of the Nasdaq securities that will be subject to the Rule on April 2, 2001 can be found in Attachment C of this *Notice*. Members should consult with the NYSE and Amex to determine their securities that initially will be subject to the Rule. On the first phase-in date, market centers must begin collecting the necessary data to prepare their monthly reports. In addition, they must make their first report, for April 2001, available by the end of May 2001.

The second phase-in date will be July 2, 2001. From that date forward, the Rule will apply to the next 1000 NYSE securities, the next 1000 Nasdaq securities, and the next 200 Amex securities with the highest average daily share volume for the quarter ending March 31, 2001. The third and final phase-in of the Rule will begin on October 1, 2001. From that date forward, the Rule will apply to all national market system securities.

## Endnotes

- 1 Generally, Rule 11Ac1-6 requires broker/dealers to disclose the identity of market centers to which they route orders on behalf of customers. The compliance date for Rule 11Ac1-6 is July 2, 2001. However, unlike Rule 11Ac1-5, it imposes obligations solely on members and does not involve any joint SRO plan that determines details of those obligations. Accordingly, this *Notice* only addresses Rule 11Ac1-5 and member obligations under the joint plan required by that rule.
- 2 National market system securities are designated under Exchange Act Rule 11Aa2-1, which incorporates the definition of reported security used in Exchange Act Rule 11Aa3-1. Currently, this designation applies to exchange-listed equities and equities included in the National Market tier of Nasdaq.
- 3 While the Rule emphasizes disclosure of execution price and speed, it does not purport to encompass all information relevant to order execution quality. The Rule specifically notes that the information required “does not create a reliable basis to address whether any particular broker/dealer failed to obtain the most favorable terms reasonably available under the circumstances for customer orders.”
- 4 Members should be aware that their obligations under the Rule could commence prior to approval of the proposed joint plan. In the event that a plan has not been approved by the SEC prior to the compliance date of the Rule (April 2, 2001), the Rule requires each market center to prepare their reports in a “consistent, usable, and machine-readable electronic format, and make such reports available for downloading from an Internet web site that is free and readily accessible to the public.”

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