

SEC Adopts New Transparency Requirements for NMS Stock Alternative Trading Systems

August 21, 2018

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The SEC recently adopted amendments to Regulation ATS and related rules (the “**Amendments**”) under the Exchange Act to enhance operational transparency and regulatory oversight of alternative trading systems (“**ATSs**”) that trade National Market System stocks (“**NMS Stock ATSs**”).¹ New Rule 304 of Regulation ATS will require NMS Stock ATSs to file with the SEC a new Form ATS-N, which will require detailed public disclosures regarding the activities of the NMS Stock ATS’s broker-dealer operator (“**Broker-Dealer Operator**”) and its affiliates and the manner of operation of the NMS Stock ATS.

Regulation ATS exempts a broker-dealer that operates an exchange-like trading platform from registration as a national securities exchange (the “**ATS Exemption**”), provided that certain conditions are satisfied, including that the ATS provides the SEC with general information about its operations on Form ATS. Regulation as an ATS has traditionally been significantly less burdensome than regulation as a national securities exchange. Exchanges must publicly file proposed rule changes with the SEC, often requiring prior approval, while Form ATS is not made public and is automatically effective. Questions regarding this disparate regulatory structure have increased in recent years, particularly as the SEC brought several enforcement actions against Broker-Dealer Operators on the basis that the ATSs failed to comply with customer confidentiality requirements, made features of the ATS selectively available to certain customers without disclosure, or failed to disclose the extent of their own or an affiliate’s trading on the ATS. The Amendments address this regulatory disparity, although they do not bring the regulation of NMS Stock ATSs to the level of national securities exchanges, and are less burdensome than initially proposed.

Under the Amendments, NMS Stock ATSs will be required to file and update Form ATS-N instead of Form ATS. Form ATS-N will be made publicly available and will require NMS Stock ATSs to disclose much more granular information. Though Form ATS-N will not need to be affirmatively approved by the SEC, the SEC will have 120 calendar days (which can be extended) to review the Form ATS-N, and can issue an order declaring the Form ATS-N ineffective, as described further below.

In addition to requiring a new Form ATS-N, the Amendments will provide the SEC with a new authority to suspend, limit, or revoke the ATS Exemption for an NMS Stock ATS. The Amendments will also require that

¹ SEC, Regulation of NMS Stock Alternative Trading Systems, 83 Fed. Reg. 38768 (Aug. 7, 2018), available [here](#) (“**Adopting Release**”). National Market System stocks are generally exchange-listed equities.

all ATSS (including non-NMS Stock ATSS) document their safeguards and procedures to protect subscribers' confidential trading information. These safeguards were already required but were not explicitly required to be memorialized in writing.

The Amendments will become effective on October 9, 2018. As a result, all ATSS must memorialize their safeguards and procedures to protect confidential trading information before that date. However, Rule 304 imposes separate compliance dates for Form ATS-N:

- An entity seeking to operate as an NMS Stock ATS for the first time after January 7, 2019, will be required to file an initial Form ATS-N and await SEC review before initiating operations.
- Any NMS Stock ATS operating pursuant to a Form ATS on file with the SEC as of January 7, 2019 (a "**Legacy NMS Stock ATS**") must file with the SEC an initial Form ATS-N no earlier than January 7, 2019, and no later than February 8, 2019, but will be permitted to operate during the SEC review period.

Form ATS-N Filing and Review Process

In order for an NMS Stock ATS to rely on the ATS Exemption, the NMS Stock ATS must properly file an initial Form ATS-N with the SEC and such Form ATS-N must be effective.² Rule 304 provides that the Form ATS-N will become effective, unless declared ineffective, upon the earlier of (i) the completion of the SEC's review and the publication of the Form ATS-N by the SEC, or (ii) the expiration of the SEC's review period (or extended review period, if applicable). The Form ATS-N is not made public upon filing, but is made public when published by the SEC after its review.

The default SEC review period for an initial Form ATS-N is 120 calendar days from the date of filing; however, if the Form ATS-N is unusually lengthy or raises novel or complex issues, the SEC may extend the review period for (i) an additional 120 calendar days for Legacy NMS Stock ATSS or 90 calendar days for all other NMS Stock ATSS, or (ii) such other period that is agreed to in writing by the NMS Stock ATS. An NMS Stock ATS may generally amend its initial Form ATS-N during the SEC's review period pursuant to the procedures described under "Form ATS-N Amendments" below. However, if a non-Legacy NMS Stock ATS intends to make a material change, that ATS must withdraw and refile its Form ATS-N.

Following its review, the SEC may, by order, declare an initial Form ATS-N ineffective after notice and opportunity for hearing. The SEC may declare an initial Form ATS-N filing ineffective if, for example, the Form ATS-N was filed by an entity that does not meet the definition of NMS Stock ATS, one or more disclosures reveal non-compliance with federal securities laws, or the rules or regulations thereunder, including Regulation ATS, or the

² NMS Stock ATSS trading both NMS stocks and other securities (e.g., corporate or municipal fixed income securities, U.S. Government securities or OTC equity securities) will be required to file and update Form ATS-N with respect to NMS stocks and Form ATS with respect to such other securities.

Deficient Disclosures

Examples of Form ATS-N disclosures that may be deficient include:

- where an NMS Stock ATS discloses an order type on Form ATS-N but does not describe the key attributes of the order type, such as time-in-force limitations that can be placed on the ability to execute the order, the treatment of unfilled portions of orders, or conditions for cancelling orders in whole or in part;
- an NMS Stock ATS describes some of its priority rules but fails to describe conditions or exceptions to its priority rules, or fails to describe any priority overlays; or
- a Form ATS-N includes inconsistent information among the disclosures.

The SEC will also conduct a “red-flag” review for instances of non-compliance with federal securities laws that seem apparent from the disclosures on Form ATS-N, for example, if the Form ATS-N suggested that the ATS would permit subscribers to price orders in sub-pennies, which would be inconsistent with Regulation NMS.

disclosures are materially deficient with respect to completeness or comprehensibility. The SEC’s review will not focus on the merits of the Form ATS-N disclosures, such as determining the strengths and weaknesses of the trading platform or a protocol offered by the NMS Stock ATS. If the SEC declares an initial Form ATS-N ineffective, the NMS Stock ATS will be prohibited from operating as an NMS Stock ATS pursuant to Regulation ATS, and the SEC’s order of ineffectiveness will be made publicly available.³

Form ATS-N Disclosures

Part I: Identifying Information

Part I of Form ATS-N will require disclosure of basic identifying information, including the name of the NMS Stock ATS and its Broker-Dealer Operator, the website URL of the NMS Stock ATS, and the primary and secondary (if any) physical street address(es) of the NMS Stock ATS matching system. In addition, unless available on the NMS Stock ATS’s website, the NMS Stock ATS must attach Schedules A and B of the Broker-Dealer Operator’s Form BD, which provide information relating to a broker-dealer’s direct and indirect owners and executive officers.

Part II: Activities of the Broker-Dealer Operator and its Affiliates

Part II of Form ATS-N will require disclosure of information regarding the Broker-Dealer Operator and its affiliates. It is designed to provide market participants with information necessary to evaluate potential conflicts of interest and information leakage. Specifically, this part will require an NMS Stock ATS to, among other things:

- name and describe each type of business unit or affiliate of the Broker-Dealer Operator that enters or directs the entry of orders and trading interest into the ATS (and the capacity of its orders and trading interest);
- explain any differences in the services that are offered or provided to business units or affiliates of the Broker-Dealer Operator as compared to other subscribers;
- identify whether and how subscribers can opt out from interacting with orders and trading interest of the Broker-Dealer Operator or its affiliates in the ATS;
- summarize the terms and conditions of any formal or informal arrangements between the Broker-Dealer Operator and a trading center to access the NMS Stock ATS services; and

³ In addition to the requirement that the SEC provide an opportunity for hearing prior to making an ineffectiveness determination, the SEC anticipates a dialogue between SEC staff and the NMS Stock ATS regarding the Form ATS-N disclosures and an NMS Stock ATS will generally have the opportunity to amend its initial Form ATS-N during the SEC’s review period. If a non-Legacy NMS Stock ATS nonetheless anticipates that the SEC will declare its initial Form ATS-N ineffective, the NMS Stock ATS could withdraw its Form ATS-N and refile at a later date or agree to a longer SEC review period, so that it has time to address the SEC’s concerns. A Legacy NMS Stock ATS would not be permitted to withdraw its initial Form ATS-N unless it ceases its operations, but it could consent to a longer SEC review period.

- identify, and summarize the conditions for use of, any products or services offered to subscribers by the Broker-Dealer Operator for the purpose of effecting transactions or submitting, disseminating, or displaying orders and trading interest in the NMS Stock ATS (e.g., algorithmic trading products that send orders to the ATS, order management or order execution systems, data feeds regarding orders and trading interest in, or executions occurring on, the ATS).

Part III: Manner of Operations

Part III of Form ATS-N is designed to provide market participants with information about how the ATS operates, including how subscribers' orders and trading interest are handled, matched and executed. Among other things, this part will require an NMS Stock ATS to:

- select the type(s) of subscribers that can use the services of the NMS Stock ATS;
- summarize the terms and conditions for any co-location and related services offered by the NMS Stock ATS, including the speed and connection (e.g., fiber, copper) options offered;
- identify and explain each order type offered by the NMS Stock ATS;
- identify whether orders and trading interest can be designated to interact or not interact with certain orders or trading interest in the NMS Stock ATS and, if so, explain the counterparty selection procedures; and
- identify and describe any fees or charges for use of the services of the NMS Stock ATS, including the type of fees (e.g., subscription, connectivity), the structure of the fees (e.g., fixed, volume-based, transaction-based), variables that impact the fees (e.g., types of securities traded, block orders, form of connectivity to the ATS), differentiation among types of subscribers (e.g., broker-dealers, institutional investors, retail) and range of fees (e.g., high and low).

Part IV: Contact Information, Signature Block, and Consent to Service

Part IV of Form ATS-N will require contact information for a representative of the Broker-Dealer Operator prepared to respond to questions regarding the form. This contact information will not be made public. Part IV will also require the NMS Stock ATS to consent that service of any civil action brought by, or notice of any proceeding before, the SEC or a self-regulatory organization in connection with the ATS's activities may be given by registered or certified mail or email at the addresses provided in the Form ATS-N. Finally, Part IV must include a representation from the NMS Stock ATS and the individual signing the Form ATS-N that the information and statements contained in, attached to, or filed in connection with, the Form ATS-N are current, true and complete.

Form ATS-N Amendments

Rule 304 will require NMS Stock ATSs to periodically update the information in Form ATS-N to ensure that it remains accurate. Specifically, an NMS Stock ATS will be required to amend its Form ATS-N for a(n):

Material Changes

The following scenarios would be particularly likely to involve a material change:

- a Broker-Dealer Operator or its affiliates beginning to trade on the NMS Stock ATS;
- a change to the Broker-Dealer Operator's written safeguards and procedures to protect the confidential trading information of subscribers;
- a change to the types of participants on the NMS Stock ATS;
- the introduction or removal of a new order type on the NMS Stock ATS;
- 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; and
- a change of a service provider to the operations of the NMS Stock ATS that has access to subscribers' confidential trading information.

An NMS Stock ATS should 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.

1. **Material Amendment** – at least 30 calendar days, except as provided by (4) below, *prior* to the date of implementation of a material change to the operations of the NMS Stock ATS or to the activities of the Broker-Dealer Operator or its affiliates that are subject to disclosure on Form ATS-N;
2. **Updating Amendment** – no later than 30 calendar days *after* the end of each calendar quarter to correct information that has become inaccurate or incomplete for any reason and was not required to be reported as a Form ATS-N amendment pursuant to (1), (3) or (4);
3. **Correcting Amendment** – promptly, to correct information in any previous disclosure on Form ATS-N, after discovery that any information previously filed on Form ATS-N was materially inaccurate or incomplete when filed; or
4. **Order Display and Fair Access Amendment** – not later than seven calendar days *after* the information required to be disclosed in Part III, Items 24 and 25 on Form ATS-N has become inaccurate or incomplete. These items ask whether the NMS Stock ATS has exceeded the order display and execution access or fair access volume thresholds in Rules 301(b)(3) and (5) of Regulation ATS.

A change to the operations of an NMS Stock ATS, or the disclosures regarding the activities of the broker-dealer operator and its affiliates, would be material 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.

The SEC's review of Form ATS-N amendments will be similar to its review of initial Form ATS-N filings; the SEC will not conduct a merit-based review, but rather will focus on the completeness and comprehensibility of the disclosures. In addition, as with initial filings of Form ATS-N, the SEC will not formally approve amendments to Form ATS-N, but may declare an amendment ineffective if the SEC finds that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors. The SEC will have 30 days from the date of the amendment's filing to declare an amendment ineffective. If the 30-calendar day review period elapses and the SEC has not declared an amendment ineffective, the NMS Stock ATS may commence operating pursuant to the Form ATS-N amendment.

In general, Updating, Correcting and Order Display and Fair Access Amendments will be made public by the SEC upon filing. The cover page of a Material Amendment, which must provide a brief narrative about the content of the Material Amendment, will also be made public upon filing, but the entirety of a Material Amendment will be made public following the expiration of the SEC's review period, unless it is declared ineffective. In addition, the SEC will publish any order declaring a Form ATS-N amendment ineffective.

Suspension, Limitation or Revocation of Exchange Exemption

Pursuant to Rule 304(a)(4), the SEC will have the authority to suspend for a period not exceeding twelve months, limit or revoke the ATS Exemption for an NMS Stock ATS.

This process will allow the SEC to address specific disclosures or activities that are the cause of the non-compliance with Regulation ATS or that violate federal securities laws. Further, the SEC's choice of sanction would depend on the particular facts and circumstances. For example, if it finds that an NMS Stock ATS implemented a material change to its operations, but failed to disclose the material change on its Form ATS-N, the SEC could decide to allow the ATS to continue to operate as disclosed on its Form ATS-N, but prohibit the ATS from engaging in the undisclosed activity until the ATS properly amends its Form ATS-N. On the other hand, the SEC would revoke the exemption of an NMS Stock ATS that no longer meets the definition of NMS Stock ATS or is no longer a registered broker-dealer, as these conditions are fundamental to the ATS Exemption. The SEC may also revoke the ATS Exemption of an NMS Stock ATS if, for example, the NMS Stock ATS appears to be violating, or to have violated, the antifraud provisions of the federal securities laws.

An NMS Stock ATS that has had its ATS Exemption suspended or limited, depending on the facts and circumstances, may be permitted to file a Form ATS-N amendment or revise its operations to come into compliance with the conditions of the ATS Exemption or the provision of any other federal securities law that may have been the basis of the SEC's findings. However, if the SEC were to revoke the ATS Exemption of an NMS Stock ATS and the entity wished to continue operations, the entity could do so only by registering as a national securities exchange or obtaining another exemption. The entity would also not be prohibited from filing a new Form ATS-N.

Written Safeguards and Procedures to Protect Confidential Trading Information

Regulation ATS currently requires ATSS to have in place safeguards and procedures to protect subscribers' confidential trading information, including adequate oversight procedures to ensure the above safeguards and procedures are followed. To enable the SEC and applicable self-regulatory organizations to evaluate compliance with these requirements, the Amendments will require all ATSS to document such safeguards and procedures in writing. Each NMS Stock ATS will also be required to describe these written safeguards and procedures in its Form ATS-N, as well as provide a summary of the roles and responsibilities of persons that have access to confidential trading information, the confidential trading information that is accessible by them, and the basis for the access.

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