

New SEC Rules Mandate Public Disclosures and Enhance NMS Stock ATS Oversight

ATSs that trade NMS stocks should prepare for new Form ATS-N filings requiring substantial public disclosure of their operations and their broker-dealer operator's ATS-related activities.

Summary

On July 18, 2018, the US Securities and Exchange Commission (SEC) voted to adopt amendments to Regulation ATS.¹ The amendments require alternative trading systems (ATSs) that trade National Market System stocks (NMS Stock ATSs) to file detailed public disclosures on new [Form ATS-N](#). These disclosures will include ATSs' manner of operations and the ATS-related activities of the broker-dealer that operates the NMS Stock ATS and its affiliates. The amendments provide for the SEC review of Form ATS-N and a potential declaration of ineffectiveness of a Form ATS-N, after notice and opportunity for hearing, which will disqualify an NMS Stock ATS for the exemption from the definition of "exchange." The amendments also require all ATSs to establish written safeguards and written procedures to protect subscribers' confidential trading information.

Background

The regulatory regime established by Regulation ATS in 1998 provides a framework for certain trading centers to be exempt from the definition of an exchange (and therefore, not to be required to register as national securities exchanges²) if they otherwise comply with the conditions and requirements of Regulation ATS. These conditions and requirements include registration as a broker-dealer, filing with the SEC an initial operation report on Form ATS at least 20 days prior to commencing operation as an ATS and filing an amendment on Form ATS at least 20 days prior to implementing any material change to the operation of the ATS.³ In addition, ATSs must permit the examination and inspection of their premises, systems, and records, and cooperate with the examination, inspection, or investigation of subscribers — whether conducted by the SEC or by a self-regulatory organization of which such subscriber is a member. Furthermore, ATSs are required to comply with recordkeeping and reporting requirements.⁴ ATSs are also required to establish adequate safeguards and procedures to protect subscribers' confidential trading information and adopt and implement adequate oversight procedures to ensure that the safeguards and procedures established are followed.⁵ Certain ATSs are also required to comply with requirements regarding order display and execution access, subscribers' fees, fair access, and systems capacity, integrity, and security.⁶

Since the adoption of Regulation ATS in 1998, the SEC has observed significant increases in the number of ATSs and the volume of NMS stocks traded on ATSs. NMS Stock ATSs have become an integral part of the national market system and are a significant source of liquidity for NMS stocks. Meanwhile, with technology advancements, NMS Stock ATSs are able to offer complex services and functionalities to execute orders in NMS Stocks. This includes a wide range of order types, matching systems, order interaction protocols, or opportunities to customize trading parameters. Furthermore, NMS Stock ATSs can use advanced technology to compete in speed, capacity, and efficiency of order interaction and execution with national securities exchanges.

The SEC also has observed relationships between broker-dealer operators of NMS Stock ATSs and the NMS Stock ATSs they operate becoming more complex and intertwined. The broker-dealer operator may have a multi-service business and engage in significant brokerage and dealing activities in NMS Stocks, in addition to the operation of the NMS Stock ATSs. A multi-service broker-dealer operator may not only charge their ATS subscribers bundled fees for use of an NMS Stock ATS and other services the operator offers, but may also use the ATS to complement its other service lines. These non-ATS service lines may compete with the ATS the multi-service broker-dealer operates for the execution of NMS Stock transactions, which gives rise to the potential for conflicts of interests between the interests of the broker-dealer operator (and its affiliates) and subscribers that use the services of the NMS Stock ATS. Moreover, this raises the potential for the broker-dealer operator's affiliates or its other business units to misuse confidential trading information.

Although NMS Stock ATSs are required to file an initial operations report and subsequent amendments on Form ATS with the SEC, and report transaction volume on Form ATS-R on a quarterly basis under the Regulation ATS adopted in 1998, these filings are deemed confidential. Little information about NMS Stock ATSs is publicly available to enable market participants to evaluate their ability to access NMS Stock ATSs as potential routing destinations. In addition, under the current Regulation ATS, Form ATS filings merely provide notice to the SEC, and ATSs are not required to obtain the SEC's approval in order to commence operations or implement a material change to their operations.

According to the SEC, lack of transparency about operations of NMS Stock ATSs and lack of publicly available information about the ATS-related activities of the broker-dealer operator and their affiliates may limit market participants' ability to access NMS Stock ATSs as potential trading venues, hinder their ability to evaluate potential conflicts of interests, and create competitive imbalance between NMS Stock ATSs and national securities exchanges that list the same NMS Stocks for trading. These regulatory concerns underlie the SEC's adoption of the Regulation ATS amendments to require new public disclosure to bring the operational transparency for NMS Stock ATSs more in line with national securities exchanges requirements and to facilitate SEC oversight of NMS Stock ATSs.

New Amendments to Regulation ATS

Heightened Regulatory Requirements for NMS Stock ATSs

1. New Conditions to ATS Exemption for NMS Stock ATSs — Form ATS Filing and SEC Review

Under the amendments, a new NMS Stock ATS must file an initial Form ATS-N with the SEC (instead of the current Form ATS). The Form ATS-N must become effective in order for the NMS Stock ATS to be exempt from the definition of an exchange and operate as an NMS Stock ATS.

Form ATS-N will become effective unless the SEC, by order, declares the Form ineffective by the end of its review period, after notice and opportunity for hearing. The SEC will have 120 days from the date of filing Form ATS-N to review. The SEC may extend for an additional 90 days if the Form ATS-N is

unusually lengthy or raises novel or complex issues that require additional time for review, or if the NMS Stock ATS agrees to extend the review period in writing. If the SEC declares a Form ATS-N ineffective, the NMS Stock ATS will be prohibited from operating as an NMS Stock ATS. However, an ineffective Form ATS-N will not prevent the NMS Stock ATS from subsequently filing a new Form ATS-N.

An NMS Stock ATS that is already operating pursuant to a previously filed Form ATS (Legacy NMS Stock ATSs) will also be required to file an initial Form ATS-N no earlier than January 7, 2019 and no later than February 8, 2019. This filing will supersede the Form ATS previously filed by the Legacy NMS Stock ATS. The Legacy NMS Stock ATS may continue to operate on a provisional basis pursuant to the filed initial Form ATS-N during the SEC review of the initial Form ATS-N. The SEC will have 120 days from the filing to review the initial Form ATS-N filed by a Legacy NMS Stock ATS. The SEC also may extend the review period for an additional 120 days if the Form ATS-N is unusually lengthy, or if the Form raises novel or complex issues that require additional time for review, or if the Legacy NMS Stock ATS agrees to extend the review period in writing. Similar to an initial Form ATS-N filed by a new NMS Stock ATS, an initial Form ATS-N filed by a Legacy NMS Stock ATS will become effective unless the SEC, by order, declares it ineffective by the end of its review period, after notice and opportunity for hearing.

2. Form ATS-N Amendment

An NMS Stock ATS is required to amend an effective Form ATS-N in four circumstances, each within the specified time frame:

- A “Material Amendment” must be filed at least 30 days prior to the implementation of a material change to the operation 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.
- A “Correcting Amendment” must be filed promptly to correct information in any previous disclosure on Form ATS-N, after an NMS Stock ATS discovers that any formation previously filed on Form ATS-N was materially inaccurate or incomplete when filed.
- An “Order Display and Fair Access Amendment” must be filed no later than seven days after the information disclosed on previously filed Form ATS-N regarding order display and execution access and fair access has become inaccurate or incomplete.
- An “Updating Amendment” must be filed no later than 30 days after the end of each quarter to correct information that has become inaccurate or incomplete and was not required to be reported to the SEC as a Material Amendment, Correcting Amendment, or Order Display and Fair Access Amendment.

The SEC will have 30 days to review an amendment to Form ATS-N to declare it ineffective. If a Form ATS-N amendment is declared ineffective, the NMS Stock ATS will be prohibited from operating pursuant to the ineffective Form ATS-N amendment, but the NMS Stock ATS may subsequently file a new Form ATS-N amendment.

During the SEC review of an initial Form ATS-N filed by a new NMS Stock ATS, or during the SEC review of a Material Amendment filed by an NMS Stock ATS operating under an effective Form ATS-N, the NMS Stock ATS must file an Updating Amendment or Correcting Amendment, as applicable, to the initial Form ATS-N or the Material Amendment that is under the SEC review. On the other hand, an NMS Stock ATS cannot file a Material Amendment to a filed initial Form ATS-N or a filed Material Amendment that is under the SEC review. Instead, an NMS Stock ATS must withdraw its filed initial Form ATS-N or Material Amendment and refile an initial Form ATS-N or a new Material Amendment.

During the SEC review of an initial Form ATS-N filed by a Legacy NMS Stock ATS, the Legacy NMS Stock ATS is required to amend its initial Form ATS-N by filing a Material Amendment, Updating Amendment, Correcting Amendment, or Order Display and Fair Access Amendment, as applicable.

3. Notice of Cessation, Suspension, Limitation, and Revocation of the Exemption from the Definition of Exchange

Under the adopted amendments, an NMS Stock ATS will also be required to file Form ATS-N to provide notice of its cessation of operations at least 10 business days prior to the date an NMS Stock ATS designates that it will cease to operate as an NMS Stock ATS.

In addition, the SEC will have the authority to, by order, after notice and opportunity for hearing, suspend for a period not exceeding 12 months, limit, or revoke the exemption for an NMS Stock ATS from the definition of an exchange.

4. Public Posting of Form ATS-N

NMS Stock ATS broker-dealer operators will submit Form ATS-N filings via EDGAR. To improve operational transparency and provide information to the market participants, the SEC will publicize on its website each of the following:

- Effective initial Form ATS-N, as amended
- Order of ineffective initial Form ATS-N
- Effective Material Amendment, as amended
- Updating Amendment, Correcting Amendment, and Order Display and Fair Access Amendment upon filing (except that an Updating or Correcting Amendment to a Material Amendment will be made public following the effectiveness of the Material Amendment)
- Order of ineffective Form ATS-N amendment
- Notice of cessation on Form ATS-N
- Order suspending, limiting, or revoking the exemption for an NMS Stock ATS from the definition of an exchange

Each NMS Stock ATS is also required to post on its website a hyperlink to the SEC's website that contains the public disclosures of its Form ATS-N, any amendments to Form ATS-N, and related SEC orders.

5. Form ATS-N Disclosures

New Form ATS-N requires an NMS Stock ATS to respond to each item of Form ATS-N "in detail" unless otherwise provided (*i.e.*, if the request indicates that the ATS is required to disclose "summary" information). The signatory is required to certify that the information and statements provided in the Form ATS-N, including exhibits, schedules, or other documents attached to the Form ATS-N, and other information filed with the Form ATS-N, are current, true, and complete. In addition, every Form ATS-N would constitute a report under the Exchange Act and therefore, 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. Although existing Form ATS also requires authorized persons to certify that the information and statements in the form are current, true, and complete, Form ATS-N will require more detailed disclosures than Form ATS.

Form ATS-N contains four parts. Part I requires certain identifying information of the NMS Stock ATS and its broker-dealer operator, such as the name of the NMS Stock ATS, the broker-dealer operator's registration, the SEC file number and CRD number of the broker-dealer operator, the website URL of the NMS Stock ATS, and the ownership and executive officers of the broker-dealer operator.

The most important disclosures are in Parts II and III of Form ATS-N. Part II of Form ATS-N is designed to provide subscribers and market participants with information about the competing interests of the broker-dealer operator or its affiliates and requires information about:

- The operation of the NMS Stock ATS and of its broker-dealer operator, or any arrangements the broker-dealer operator may have made, whether contractual or otherwise, pertaining to the operation of its NMS Stock ATS (such as products and services offered by the broker-dealer operator/affiliates to subscribers for the purpose of effecting transactions or submitting, disseminating, or displaying orders or trading interest in the NMS Stock ATS)
- ATS-related activities of the broker-dealer operator and its affiliates that may give rise to conflicts of interest for the broker-dealer operator and its affiliates, or the potential for information leakage of subscribers' confidential trading information (such as the broker-dealer operator or affiliates' trading activities on the ATS, order interaction with broker-dealer operator and/or affiliates, and arrangements between the broker-dealer operator/affiliates and a trading center to access the NMS Stock ATS services)
- Safeguarding subscribers' confidential trading information (such as activities of service providers, including shared employees and third-party service providers and written procedures to protect confidential trading information and whether subscribers can consent to and withdraw consent to the disclosure of their confidential trading information)

Part III of Form ATS-N is designed to provide public disclosures to help market participants understand, among other things, how subscribers' orders and trading interest are handled, matched, and executed on the NMS Stock ATS. Each NMS Stock ATS would be required to disclose detailed information regarding, for example, order types and attributes, order sizes, any segmentation or order, counterparty selection, order display, order routing, fees charged for use of the ATS's services, order display and execution access, fair access, aggregation of platform data, *etc.*. The items in Part III to which each NMS Stock ATS is required to respond in detail can be found [here](#).

Finally, Part IV requires the contact information of the person at the NMS Stock ATS prepared to respond to questions for the Form ATS-N submission, signature block, and consent to service.

Written Safeguards and Written Procedures to Protect Confidential Trading Information

The SEC also adopted amendments to Rule 301(b)(10) of Regulation ATS, which requires every ATS to have in place safeguards and procedures to protect subscribers' confidential trading information. Rule 301(b)(10) does not currently require that the safeguards and procedures be in writing. The amendments will require all ATSs to establish and maintain adequate written safeguards and written procedures to protect subscribers' confidential trading information and to adopt and implement adequate written oversight procedures to ensure that the written safeguards and procedures established to protect confidential trading information are followed.

Effective Date and Compliance Date

The amendments to Regulation ATS described above will become effective 60 days after the date of publication in the Federal Register. The compliance date for an entity seeking to operate as a new NMS Stock ATS is January 7, 2019. Each Legacy NMS Stock ATS is also required to file an initial Form ATS-N no earlier than January 7, 2019 and no later than February 8, 2019. During the transition period, each Legacy 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, must continue to comply with the notice requirement in Rule 301(b)(2)(i) through (vii). This includes the requirement to file amendments and file a cessation report on Form ATS, until the Legacy NMS Stock ATS files an initial Form ATS-N with the SEC.

Changing Competitive Landscape of NMS Stock Trading Centers

Currently, most of NMS Stock ATSs operate as dark pools, *i.e.*, they do not publicly display quotations in the consolidated quotation data. The amendments to Regulation ATS will impose substantial disclosure obligations on NMS Stock ATSs to publicize detailed information regarding the activity of their broker-dealer operator and affiliates, their safeguards to protect subscribers' confidential trading information, and the manner of their operation. Such disclosures will enable market participants to assess how orders interact, match, and execute on an NMS Stock ATS and compare to other NMS Stock ATSs and national securities exchanges. As the adopted amendments significantly reduce regulatory differences in disclosure obligations between NMS Stock ATSs and national securities exchanges, the competitive imbalance between NMS Stock ATSs and national securities exchanges may change. The amendments may also increase the barriers to entry to the NMS Stock ATS playing field.

Will Non-NMS Stock ATSs Be Subject to Similar Transparency and Oversight?

The amendments (except for written safeguards and written procedures to protect confidential trading information) do not apply to ATSs that trade over-the-counter equity securities, government securities, municipal securities, and corporate debt securities. The SEC will continue to evaluate the need to impose operational transparency requirements on non-NMS Stock ATSs. The SEC's Fixed Income Market Structure Advisory Committee has recommended that the SEC review the regulatory framework for oversight of electronic trading platforms used in the municipal securities and corporate bond markets. Whether the regulation and oversight of non-NMS Stock ATSs will be subject to similar enhanced disclosure and oversight as the NMS Stock ATSs remains to be seen.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Wenchi Hu

wenchi.hu@lw.com
+1.212.906.1655 / +1.202.637.2361
New York / Washington, D.C.

Vivian A. Maese

vivian.maese@lw.com
+1.212.906.1302
New York

Louis Trotta

louis.trotta@lw.com
+1.212.906.1662
New York

Brett M. Ackerman

brett.ackerman@lw.com
+1.202.637.2109
Washington, D.C.

You Might Also Be Interested In

[SEC Takes Enforcement Action and Issues Statement on Digital Asset Trading Platforms](#)

[SEC's Recent BitFunder Charges and Statement on Digital Asset Trading Platforms — What They Mean to Crypto Market Participants](#)

[Is the SEC's Proposed "Best Interest" Standard for Broker-Dealers in Anyone's Best Interest?](#)

[Global Developments on Best Execution](#)

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the lawyer with whom you normally consult. The invitation to contact is not a solicitation for legal work under the laws of any jurisdiction in which Latham lawyers are not authorized to practice. A complete list of Latham's *Client Alerts* can be found at www.lw.com. If you wish to update your contact details or customize the information you receive from Latham & Watkins, visit <https://www.sites.lwcommunicate.com/5/178/forms-english/subscribe.asp> to subscribe to the firm's global client mailings program.

Endnotes

¹ See SEC Release No. 34-83663, Available at <https://www.sec.gov/rules/final/2018/34-83663.pdf>.

² See Rule 3a1-1(a)(2), 17 CFR 240.3a1-1(a)(2) and Rules 300-303, 17 CFR 242.300-303.

³ See Rule 301(b)(1)-(2), 17 CFR 242.301(b)(1)-(2).

⁴ See Rule 301(b)(7)-(8), Rules 302 and 303, 17 CFR 242.301(b)(7)-(8), 302-303.

⁵ See Rule 301(b)(10), 17 CFR 242.301(b)(10).

⁶ See Rule 301(b)(3)-(6), 17 CFR 242.301(b)(3)-(6).