

SEC Tightens Alternative Trading Platform Oversight

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On July 18, 2018, the SEC ramped up its oversight of alternative trading systems (“ATs”) by adopting a series of [rule amendments](#) imposing public disclosure requirements on ATs that trade NMS (“National Market System”) stocks (*i.e.*, stocks listed on a national securities exchange). The amendments also require ATs to establish written procedures to protect subscribers’ confidential trading information. [Initially proposed in 2015](#), the amendments will take effect on October 9, 2018, per the July 18th Notice of Final Rulemaking.

As set forth in [Regulation ATS](#), issued by the SEC in 1998, ATs are trading platforms that facilitate securities transactions by providing a marketplace where buyers and sellers come together to collect and execute orders. As its name implies, an AT is an alternative trading venue to a national securities exchange, such as the NASDAQ or New York Stock Exchange, [where transactions typically occur through electronic, automated means](#). According to Regulation ATS, an AT is not an exchange because it lacks authority to establish rules of conduct for subscribers other than for trading, and disciplines subscribers other than by exclusion from trading. As such, rather than registering as an exchange, an AT must register with the SEC as a broker-dealer. As explained in the 2015 [Notice of Proposed Rulemaking](#), NMS stock ATs are commonly known as “dark pools,” because they do not display quotations to the public. Today, [by the SEC’s calculations](#), nearly 90 NMS stock ATs trade alongside national securities exchanges, taking up approximately 11% of the market, which represents an almost 50% increase since 2009.

Under the amendments, a broker-dealer seeking to operate an AT may not do so until it has made requisite disclosures to the SEC, and the SEC approves its eligibility to be exempt from registration as an exchange. Such disclosures occur via Form ATS-N, which seeks information regarding the AT’s manner of operations, its managing broker-dealer, the broker-dealer’s affiliates, and the broker-dealer’s AT-related activities. Once the SEC approves Form ATS-N, it will be publicly available on the SEC’s EDGAR system, which the AT must link on its own website. Alternatively, the amendments create a process for the SEC to deny AT status by declaring Form ATS-N filings ineffective, after providing notice and an opportunity to be heard.^[1] Before these amendments, an NMS stock AT did not need to obtain the SEC’s approval before operating, and its disclosures to the SEC were deemed confidential.

According to the SEC, the amendments are crucial to boost the level of transparency required of NMS stock ATSS, as they have skyrocketed in number since ATSS began operating. [In a public statement](#) at an SEC open meeting, Chairman Jay Clayton noted that NMS stock ATSS regularly compete with national securities exchanges for order flow of the same securities, yet there is a significant difference in the information that these platforms must share with the public. The recent rulemaking is meant to correct this disparity by ensuring that investors have access to information necessary to understand how NMS stock ATSS work, and select the trading platform that best suits their needs. Such information is especially necessary given the rising operational complexity of many NMS stock ATSS, as well as the potential for conflicts of interest created by the dual roles of broker-dealers as ATSS operators and as brokers.

[In her own statement](#) at the open meeting, Commissioner Kara Stein implied that the amendments constitute an important step in protecting investors from fraud. As many dark pools have operated in “secrecy” without public disclosure requirements, the Commission has brought a number of enforcement actions based on the failure to disclose material information about how they function. *See, e.g., In the Matter of ITG Inc. and Altnet Securities, Inc.*, Exchange Act Release No. 75672 (Aug. 12, 2015) (stating that ITG admitted to operating a secret trading desk and misusing the confidential trading information of dark pool subscribers) (available [here](#)); *In the Matter of UBS Securities LLC*, Exchange Act Release No. 74060 (Jan. 15, 2015) (reporting that UBS paid more than \$14.4 million for failing to disclose to dark pool subscribers an order type that was marketed almost exclusively to market makers and high frequency trading firms, which allowed those participants to place sub-penny-priced orders that then received priority over other orders) (available [here](#)).

Stein criticized the Commission for limiting the disclosure requirements to platforms trading NMS stocks, calling for a “minimum set of rules” for *all* ATSS, including those trading over-the-counter equity securities, government securities, municipal securities, and corporate debt securities. Nonetheless, the amendments can be seen as a harbinger of a significant crackdown on NMS stock ATSS, and a heightened regulatory focus on ATSS overall.

[1] The SEC may declare a Form ATS-N defective if it finds that it is “necessary or appropriate in the public interest, and consistent with the protection of investors.” *See* Regulation of NMS Stock Alternative Trading Systems, 83 Fed. Reg. 38768, 38790 (Aug. 7, 2018) (to be codified at 17 C.F.R. pt.s

232, 240, 242, and 249). The SEC may make such a finding, for example, if the Form was filed by an entity that does not meet the proposed definition of

NMS stock ATSS; the Form reveals non-compliance with federal securities laws, or the rules or regulations thereunder; or the entity’s disclosures are

materially deficient with regard to completeness or comprehensibility. *See id.* at 38791.

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