



SECURITIES ENFORCEMENT AND REGULATORY UPDATE

SEC Adopts Amendments to Modernize Disclosure of Order Execution Information

April 18, 2024

On March 6, 2024, in a unanimous vote, the U.S. Securities and Exchange Commission (SEC) adopted amendments to the disclosure requirements under Rule 605 of Regulation NMS for executions on covered orders in national market system (NMS) stocks (the Final Rule).¹ The Final Rule seeks to modernize and enhance execution quality reporting and, among other things, (i) expands the scope of entities subject to Rule 605, (ii) modifies the categorization and content of order information required to be reported, and (iii) requires reporting entities to produce a summary report of execution quality.

The Final Rule amendments will become effective 60 days after publication of the adopting release in the *Federal Register*. The amendments have a compliance date of 18 months after the effective date — that is, sometime during Q4 2025 or Q1 2026.

Key Takeaways

The Final Rule will increase data made available under Rule 605 to the public about securities transaction execution quality. Affected entities should review the Final Rule and consider the mechanisms by which they can capture and report the newly proposed information.

The Final Rule expands the scope of reporting entities subject to Rule 605 to include broker-dealers that introduce or carry 100,000 or more customer accounts. This means all broker-dealers will need to develop processes for monitoring the number of customer accounts they introduce or carry to determine whether they may be subject to Rule 605 disclosure requirements.

Under the Final Rule, the definition of “covered order” is expanded to include certain orders submitted outside of regular trading hours, certain orders submitted with stop prices, and nonexempt short sale orders. The Final Rule modifies existing order size categories to base them on both notional dollar value and whether an order is for a fractional share, an odd lot, or a round lot or greater, rather than the number of shares. The Final Rule also

establishes four new order-type categories: marketable immediate-or-cancel (IOC) orders, market orders submitted with stop prices, marketable limit orders submitted with stop prices, and nonmarketable limit orders submitted with stop prices. The Final Rule also amends the content of reports required under Rule 605 and requires all entities subject to the rule to make a summary report publicly available.

Certain aspects of the Final Rule also raise interpretive questions and operational challenges for broker-dealers. For example, under the Final Rule, broker-dealers that execute fractional share transactions on behalf of their customers may be considered over-the-counter (OTC) market makers subject to Rule 605 — potentially subjecting such broker-dealers to Rule 605 even if they do not qualify as a “larger” broker-dealer (as described in detail below). Additionally, OTC market makers will be required to provide separate Rule 605 disclosures with respect to their single-dealer platform activities, as distinct from their OTC market-making activities. The Final Rule, however, does not set forth a definition of a single-dealer platform or provide clear guidance as to how OTC market-making activity should be distinguished from single-dealer platform activity. All self-regulatory organizations that are participants in the Rule 605 NMS Plan will be required to amend the Rule 605 NMS Plan to account for new data fields. However, there is no timeline for when an amended plan is required and no requirement that the Rule 605 NMS Plan create a template for market participants to use in creating Rule 605 reports.

While Rule 605 reports have been useful to industry participants and academics conducting reviews for best execution and other purposes, we believe they are too complicated, too hard to understand, and, overall, of little utility to the average public investor. Certain of the changes here will, we hope, improve public investors’ experience.

Background

Rule 605 provides visibility into the execution quality among different market centers, but it has not been substantively updated since its adoption in 2000.² Currently, Rule 605 requires market centers to make available, on a monthly basis, standardized information concerning execution quality for covered orders in NMS stocks that they received for execution, including specified measures of execution quality such as effective spread, average amount of price improvement, number of shares executed, and speed of execution.

Since Rule 605’s adoption, equity markets have evolved with new technologies and business models. The Final Rule seeks to modernize and enhance execution quality reporting to increase transparency and information available to investors, as well as to help promote competition among market centers and broker-dealers.

Rule 605 Amendments

Expanding Entities Subject to Rule 605 to Cover Large Broker-Dealers

The Final Rule expands the scope of reporting entities subject to Rule 605, including by requiring monthly execution quality reporting from “larger” broker-dealers — meaning broker-dealers that introduce or carry 100,000 or more customer accounts.

Currently, broker-dealers are not included within the scope of Rule 605 unless they are also “market centers.” Although Rule 606 of Regulation NMS requires broker-dealers to provide certain information regarding customer orders they route, those reports do not include comprehensive information about the execution quality achieved by such routing broker-dealers. The Final Rule is thus designed to require broker-dealers that introduce or carry more than 100,000 customer accounts to provide execution quality disclosures under Rule 605 to better inform investors of the execution quality they receive.³

The Final Rule also specifies that broker-dealers operating single-dealer platforms must prepare a separate report for activity specific to these platforms.

Amending Form and Content of Rule 605 Monthly Reports

The Final Rule also includes updates to the scope and content of Rule 605 standardized monthly reports.

First, the Final Rule expands the definition of “covered order”⁴ subject to Rule 605 to include the following:

- *Orders submitted outside of regular trading hours* — the definition includes nonmarketable limit orders (NMLO) submitted outside of regular trading hours that become executable after the opening or reopening of trading during regular trading hours.
- *Orders submitted with stop prices* — orders with special handling instructions, including orders submitted with stop prices, are currently excluded from the definition of “covered order”; under the Final Rule, stop orders are required to be reported from the time such orders become executable.⁵
- *Nonexempt short sale orders* — under the Final Rule, a nonexempt short sale order is considered a special handling order which is excluded from the definition of “covered order” if a price test restriction is in effect for the security.

Second, current Rule 605 reports group orders by order size and order type, and the Final Rule modifies existing order size categories. Specifically, the Final Rule modifies existing order size categories to base them on both notional dollar value and whether an order is for a fractional share, for an odd lot, or for a round lot or greater rather than the number of shares. The Final Rule also modifies reportable order type categories for order types as follows:

Existing Order Type Category	Order Type Category as Amended
Market	Market
	Marketable IOC
	Executable market order with stop price
Marketable limit	Marketable limit
	Marketable IOC

	Executable marketable limit order with stop price
Inside-the-quote limit	Midpoint-or-better limit orders
	Midpoint-or-better IOCs
At-the-quote limit	Executable NMLO
Near-the-quote limit	Executable NMLO submitted with stop price
	NMLO IOCs

Third, the Final Rule amends the content of Rule 605 monthly reports to include:

- average time to execution, measured in increments of a millisecond or finer, and retaining the current time-to-execution reporting categories, rather than adopting the proposed median and 99th percentage execution quality statistics
- average realized spread⁶ statistics calculated at 50 milliseconds, 1 second, 15 seconds, 1 minute, and 5 minutes after the time of execution
- new statistical measures of execution quality, including:
 - average effective over average quoted spread (a percentage-based metric that represents how much price improvement an order received) for marketable order types, marketable stop order types, and midpoint-or-better order types
 - percentage-based effective and realized spread statistics (designed to make it easier to compare dollar-based statistics across stocks) for marketable order types, marketable stop order types, and midpoint-or-better limit order types
 - size improvement benchmark that could be used to calculate whether orders received an execution of more than the displayed size at the quote
 - certain statistical measures that could be used to measure execution quality of nonmarketable orders, and additional price improvement statistics for market and marketable orders showing price improvement relative to the best available price in the market

Summary Reports

The Final Rule requires all entities subject to Rule 605 to make publicly available a summary report formatted in the most recent versions of the schema for CSV and PDF formats, as published on the SEC's website. Currently,

the required format of 605 reports is only machine-readable. Requiring summary reports, in addition to the detailed reports, would allow for a human-readable format that investors could more readily use.

Further, we believe the adoption of these changes provides an excellent opportunity for both the SEC and the Financial Industry Regulatory Authority (FINRA) to provide desperately needed guidance to public investors as to what this information means and how it can be used. A significant amount of the information provided and to be provided in Rule 605 reports is very complex and difficult to understand, and serious guidance is needed to make the reports useful for the public investor. Additionally, the SEC and FINRA should provide guidance to industry participants as to how they expect this information to be used and considered. Such guidance will be much more productive to the market than negotiated discussion in enforcement actions in years to come.

¹ Exchange Act Release No. 34-99679 (March 6, 2024), <https://www.sec.gov/files/rules/final/2024/34-99679.pdf>.

² Regulation NMS defines a “market center” to include any exchange market maker, OTC market maker, alternative trading system, national securities exchange, or national securities association.

³ According to the SEC’s analysis, approximately 85 broker-dealers introduce or carry more than 100,000 customer accounts, and they collectively handle over 98% of customer accounts.

⁴ A “covered order” includes any market order or any limit order (including IOCs) received by a market center during regular trading hours at a time when the national best bid and national best offer are being disseminated, and, if executed, is executed during regular trading hours. *See* 17 CFR 242.600(b)(27).

⁵ The Final Rule’s definition of “executable” means, for any order submitted with a stop price, that the stop price has been triggered during regular trading hours and after the primary listing market has disseminated its first firm, uncrossed quotations in the security.

⁶ *See* 17 CFR 242.600(b)(13) (defining “average realized spread”).

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