IEX Group, Inc.
4 World Trade Center, 44th Floor
New York, New York 10007
1 646 343 2000 tel
1 888 481 9706 tel
www.iextrading.com

November 15, 2017

Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Equity Market Structure Advisory Committee Recommendation for Access Fee Pilot, File No. 265-29

Dear Chairman Clayton:

Investors' Exchange LLC ("IEX") is pleased to comment on the proposal by the SEC's Equity Market Structure Advisory Committee ("EMSAC") for a pilot to test alternatives to the existing exchange fee structures ("Fee Pilot"). We submit this letter in response to comments on this topic in a recent letter from the three large U.S. exchange operators, NYSE Group, Nasdaq, and CBOE/BATS (the "Three Exchanges"), each of which operates multiple exchanges.[1]

There is a Compelling Basis for Taking Action

We strongly support the concept of a Fee Pilot because we believe the current system of exchange pricing (maker-taker and taker-maker) represents the biggest single source of conflicts and inefficiency that exists in the equity markets. This pricing system has been controversial since exchanges first started to use it over 10 years ago. Since then, it has only created more complexity and fragmentation, as recognized by a wide spectrum of broker-dealers, investors, academics, and other commentators.[2] Even the CEO of NYSE's holding company has admitted

[1] See Letter from Chris Concannon, President and Chief Operating Officer, CBOE, Thomas Wittman, CEO, The Nasdaq Stock Market LLC, and Thomas W. Farley, President, NYSE, to Brent J. Fields, Secretary, SEC (October 13, 2017).

[2] *See,* e.g., SEC Staff Memorandum to the Equity market Structure Advisory Committee on Maker-Taker Fees on Equities Exchanges, dated October 20, 2015, at 4-6.

that this pricing system has contributed to fragmenting the markets by encouraging the creation of "cloned" exchanges.[3]

It is our understanding that the Commission is considering proposing such a pilot through SEC rule making. We strongly agree that a pilot conducted by the SEC will be more constructive than one designed by the self-regulatory organizations under another national market system plan. The letter by the Three Exchanges makes it very clear that they have no interest in seeking alternatives to the current structure given how their business model has become completely reliant on the payment of rebates. Thus, they could not be relied upon to effectively oversee the creation of a Fee Pilot.

Arguments Against a Pilot by the Three Exchanges are not Credible

We believe the arguments made by the Three Exchanges are part of a familiar playbook to stave off market reform. There are three parts to their strategy: deny, deflect, and delay.

First, they deny that there is any problem to be addressed – in this case, they say the problem with exchange pricing "has not been articulated." In fact, the complaints about the maker-taker/taker-maker system, and how it has contributed to conflicts and complexity, have been voiced for many years by investors, brokers, and academics. The recent Report by the Department of the Treasury on capital markets regulatory reform[4] linked the rebate system to distorted incentives and endorsed a Fee Pilot.

Second, they try to deflect by arguing that the SEC should not look at exchange pricing without, at the same time, tackling all other payment practices throughout the industry by conducting a "holistic" review of Regulation NMS. The idea that a substantial conflict of interest cannot be addressed unless all other conflicts are addressed simultaneously is not viable. Exchange pricing stands out because of the amount of fees and rebates involved (over $2.5 billion in 2016), the inefficiencies that result from hundreds of pricing tiers, and the proven negative consequences to

---

[3] *See* Stanislav Dolgopolov, "The Maker-Taker Pricing Model and Its Impact on the Securities Market Structure: A Can of Worms for Securities Fraud?", VA. L. & BUS. REV. 231 (2014), at n. 33 (citing to statements from the Chairman and CEO of Intercontinental Exchange Group, Inc.).
[4] U.S Department of the Treasury, <u>A Financial System That Creates Economic Opportunities, Capital Markets</u> (October 6, 2017).

investors that result from routing orders to high rebate exchanges.[5] Further, the Commission has been engaged in a holistic review of market structure at least since the issuance of its Equity Market Structure Concept Release in 2010 and more recently by the work of the EMSAC, resulting in hundreds of comments and multiple staff analyses. In fact, it is the ongoing in-depth and holistic review by both the Commission and the industry that has led to consideration of the Fee Pilot.

The third part of the strategy is delay. In this case, they argue that the Commission should not even propose a pilot until it has first *completed* action on best execution guidance, broker routing disclosure, and transparency around alternative trading systems. Those are all important areas for reform, but there is no logic other than commercial protectionism in delaying action on fees and rebates until the SEC completes action on all these other topics.

The Fee Pilot Should Address Rebates Directly and Apply to Inverted Exchanges

In constructing the pilot, there are two key modifications from the EMSAC recommendation that we think are critical to conducting a worthwhile study.

First, the pilot should ban the payment of rebates for a defined set of securities (i.e. a "no rebate bucket"). There are three main reasons to do this:

1. One of the main criticisms of the current system is that rebates distort prices and trading behavior. To invest time and effort in a pilot and not test how markets operate without rebates makes little sense.
2. A "2 mil bucket" is not an effective substitute for a no rebate bucket. The longer-term impact of a significant reduction in the access fee cap could be to severely limit exchange competition and curb innovation. Consider that a 2 mil price control would force exchanges to increase other fees, such as data and connection charges, with a detrimental effect on the total cost to trade. At the same time, it would severely curtail the ability of exchanges to charge directly for their primary purpose – matching stock transactions.
3. Exchanges can and do pay rebates in excess of access fees in some circumstances, so limiting the pilot to restrictions on access fees may not achieve the purpose of a Fee Pilot,

---

[5] *See* Elaine Wah, Stan Feldman, Francis Chung, Allison Bishop, and Daniel Aisen, "A Comparison of Execution Quality Across U.S. Stock Exchanges" (April 19, 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2955297.

> namely, to evaluate alternatives to the current exchange pricing system, which is driven primarily by the rebate itself.

Because even the Three Exchanges have failed to dispute that rebates are not needed to attract quotes for the most highly-traded stocks, the no rebate bucket should include a sufficiently sized sample of high-liquidity stocks. High-liquidity stocks could be defined by index inclusion or average daily trading volume. IEX also supports an evaluation of whether to prohibit rebates generally.

Second, we believe that the Fee Pilot should include "inverted" or taker-maker exchanges that pay rebates to take liquidity. Otherwise, it will test only how much distortive pricing can be transferred to these venues, which attract order flow by paying a rebate to the remover of liquidity (instead of the provider of liquidity under the maker-taker regime). It should be noted that the practice of paying to remove liquidity disproved the notion that rebates are necessary to encourage liquidity providers long ago – inverted exchanges are now nearly 10% of total market volume and have outperformed in market share in securities with wider spreads.[6] The fact that Rule 610 of Regulation NMS only addresses fees to take liquidity does not prevent harm from the conflicted payments provided in this alternate form. The question is not just whether access fees are too high (we agree that they are), but also whether unbalanced incentives to post or take liquidity hurt market quality.

Conclusion

We are grateful that the Commission appears on track to proceed with this meaningful pilot study. We look forward to data that will empower the Commission, our industry, and academics to analyze and drive reform to expand efficiency and capital formation in the equity markets. The EMSAC recommendation was issued more than one year ago, and no one believes that concerns over maker-taker pricing have become less relevant since then. We believe that the time to proceed with the pilot is long past due.

---

[6] *See* Virtu Financial Tick Pilot Data Dashboard.

Sincerely,

Brad Katsuyama
Chief Executive Officer

John Ramsay
Chief Market Policy Officer

cc: Hon. Michael Piwowar, Commissioner
Hon. Kara Stein, Commissioner
Brett Redfearn, Director, Division of Trading and Markets
Gary Goldsholle, Deputy Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets