BLACKROCK

September 12, 2014

The Honorable Mary Jo White
Chair
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Submitted via email: rule-comments@sec.gov

RE: Equity Market Structure Recommendations; Concept Release on Equity Market Structure, File No. S7-02-10; Regulation Systems Compliance and Integrity, File No. S7-01-13; and Equity Market Structure Review

Dear Chair White:

Public statements from you and other Commissioners and staff have indicated that the Commission is considering a number of potential regulatory changes affecting US equity markets. In anticipation of these proposals, a number of market participants have issued recommendations and provided commentary.[1] BlackRock, Inc. (together with its affiliates "BlackRock")[2] is pleased to formally submit our views on this topic to provide the Commission with its buy-side perspective.

As a fiduciary for our clients, BlackRock supports the development of a market structure which fosters transparency, promotes stability, and protects investors, while preserving choice and balancing benefits versus implementation costs. We feel that the US equity market has fundamentally achieved these goals through measured, thoughtful regulation and sweeping technological innovation. Yet, while the market is not in need of wholesale reform, it is continually evolving and regulation must keep pace with structural change.

BlackRock supports targeted improvements along four main themes which will better align rules and practices with the reality of US equity market structure today. In proposing these measures, BlackRock has focused on identifying concrete and achievable changes which, if implemented, will have meaningful impact on improving

---

1 *See, e.g.*, Letter from Daniel Keegan, Managing Director, Head of Equities for the Americas, Citigroup Global Markets Inc. (August 7, 2014) (available at http://www.sec.gov/comments/s7-02-10/s70210-416.pdf); Letter from John C. Nagel, Managing Director and Sr. Deputy General Counsel, Citadel LLC (July 21, 2014) (available at http://www.sec.gov/comments/equity-market-structure-2013/equitymarketstructure2013-7.pdf); Letter from Christopher Nagy, CEO, and Dave Lauer, President, KOR Trading LLC (April 4, 2014) (available at http://www.sec.gov/comments/s7-02-10/s70210-413.pdf); SIFMA, "SIFMA Board Committee on Equity Market Structure: Recommendations as of July 10, 2014" (available at http://www.sifma.org/issues/item.aspx?id=8589949840); and SIFMA, "Submitted Statement of The Honorable Kenneth E. Bentsen, Jr., President and CEO, SIFMA and Mr. Daniel Coleman, CEO, KCG and Member, SIFMA Board of Directors" (July 28, 2014) (available at http://www.sifma.org/workarea/downloadasset.aspx?id=8589950100).

2 BlackRock is one of the world's leading asset management firms, managing approximately $4.594 trillion (as of June 30, 2014) on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurance companies and other financial institutions, as well as individuals around the world.

confidence and promoting fair and orderly markets. Some of these suggestions have also been put forward by financial industry trade organizations or Commission staff in public statements. We believe that it is essential to publicly express support for the following initiatives from an investor perspective:

- Reduce conflicts of interest by addressing exchange access fees
- Enhance transparency and regulatory surveillance
- Curtail complexity in market structure
- Ensure equal access to market data

Address Conflicts of Interest

As we noted in our market structure *ViewPoint,* exchange access fees give rise to a conflict of interest between reducing trading costs for brokers and achieving best execution for clients.[3] The current cap of 30 cents per 100 shares was established based on the prevailing pricing at trading centers prior to 2005. Since then, commissions and spreads have decreased dramatically, making these anachronistically large fees a significant component of trading cost in today's ecosystem. The access fee cap should be reduced to 5-10 cents per 100 shares in order to improve the alignment of interests among market participants and positively impact market structure.

Lowering the cap will reduce the distortive effect that rebates, fees and pricing tiers have on order routing behavior.[4] This reinforces the objective of best execution in broker routing practices. Lower fees may also encourage trading activity to migrate onto exchanges from off-exchange venues by eliminating cost as a factor in routing decisions which will improve the quality of displayed liquidity. Differentiation in pricing is limited when fee caps are reduced. This deters further proliferation of trading venues and may induce some exchanges or alternative trading systems ("ATSs") to consolidate or cease operations, which serves to reduce excessive market fragmentation that burdens investors with cost and complexity.[5] The appeal of this proposal is further enhanced by its ease of implementation – Rule 610(c) of Regulation National Market System ("NMS") establishes regulatory precedent for limiting access fees and current market infrastructure and technology readily accommodates fee changes.

Some participants have called for elimination of rebates and maker-taker pricing in its entirety in conjunction with access fees, but BlackRock believes that incentives for providing liquidity positively impact market structure. Incentives promote price discovery in public markets, increase available liquidity and tighten spreads. Rebates compensate liquidity providers for exposing orders to adverse selection and information leakage. It is not the maker-taker model in principle, but the magnitude of incentives relative to other economics which motivates improper routing decisions and inordinate competition to capture rebates. A reduction in incentives would mitigate this and de-emphasize the

---

[3] BlackRock, *ViewPoint* – US Equity Market Structure: An Investor Perspective, April 2014 (available at http://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-us-equity-market-structure-april-2014.pdf) ("Market Structure *ViewPoint*").

[4] Although seldom mentioned, volume-driven price tiers also foster conflicts of interest. Brokers may be incentivized to sub-optimally route to a venue at the end of the month in order to meet volume thresholds which will lower fees or raise rebates on all trading activity for that period. Rebates, fees, and tiers are all constrained by the level of the access fee cap.

[5] *See* Market Structure *ViewPoint* at 2-7 (discussing the costs of fragmentation).

pursuit of speed and order types which facilitate rebate capture and contribute to market complexity, message congestion and system instability.

Proposals for a trade-at rule have also been tightly coupled with access fee reform. BlackRock believes, however, that a trade-at rule may potentially increase costs for investors, and this should be separately and judiciously weighed against the benefits obtained from such a regime. The trade-at rule can take a variety of forms depending on the specific provisions for price and size improvement under which off-exchange executions may be permitted to occur.[6] At the most progressive settings, order flow may be disproportionately compelled onto displayed venues, contributing to pre-trade price impact and information leakage. This may also severely restrict the ability of investors to receive price improvement, be selective in their choice of liquidity partners, or leverage the pricing safeguards in alternative venues. We recommend that prior to adopting a trade-at rule, regulators should carefully assess the need for such an approach and determine appropriate levels for price and size improvement exceptions. We note that a number of other recommendations similarly promote displayed liquidity and price discovery, so it would be prudent to consider a trade-at rule only if further action is deemed necessary after enacting other proposals. Additionally, execution methods have evolved over the past two decades. Orders are split into smaller transactions by algorithms to manage impact and risk. It would be unrealistic to presume that institutional activity is only represented in the form of a large block. If the size improvement threshold is too high, the rule will severely impair the ability of institutions to manage information leakage. Trade-at exceptions must be carefully specified to avoid unintentionally impacting trading activity and increasing costs for investors.

Promote Transparency and Enhance Regulatory Surveillance

Transparency and sound regulatory surveillance are the foundations for investor confidence and trust. This, in turn, fosters liquidity and sustains well-functioning public markets. However, the fast pace of evolution over the past decade has created a climate where surveillance tools and disclosure practices need to be updated to reflect modern market structure. BlackRock supports measures which will further enhance transparency as to certain market practices and raise investor confidence.

Broker-dealers should be required to provide periodic standardized reports on order routing and execution metrics to retail and institutional investors. The SEC aptly addressed public disclosure of execution quality and the routing practices of broker-dealers when it adopted Rules 605 and 606 of Regulation NMS. However, rising complexity in market structure has made the existing reporting inadequate. Although market participants are still capable of monitoring execution quality, the investment and resources required to do so effectively make it difficult for all but the largest investors. This heightens the concerns about order routing practices and erodes market confidence. Revised Rule 605/606 disclosures should provide greater transparency on marketable and non-marketable limit orders, order fill rates, sub-second execution horizons, pre-/post-trade price movement, alternative order type usage and total

---

6 For instance, different proposals for the definition of price improvement have included the minimum trade increment, the mid-market of the National Best Bid and Offer ("NBBO"), a fraction of the tick size, or a stipulated percentage of the bid-offer spread. Size improvement is similarly subject to variations in its specification.

fees/rebates paid or received.[7] These metrics should also be available in a standardized template for individual customer activity, not just at an aggregate level by broker-dealer. Broker-dealers should also be directed to provide written disclosure to their clients on their order handling practices, which venues they access, and how they assess best execution when routing client orders.

Investors need more clarity on dark pool operating procedures and order management practices to determine how they should use these platforms. As a first step, current and historical Form ATS filings for currently active ATSs should be made immediately available to the public, subject to appropriate redaction of confidential information.[8] Several ATS operators have already displayed exemplary transparency by voluntarily publishing their Form ATS filings and supplemental materials. However, the particular operational features specified and degree of detail lack consistency from one submission to another. Additional standardization and information are required in disclosures about ATS practices. Mandatory ATS disclosures should include greater detail on how the platform calculates reference prices, determines order priority, matches orders between client segments, monitors execution quality, advertises orders, interacts with affiliates and is compensated by subscribers.

ATS operators should be directed to regularly conduct independent audits of their platforms to ensure that they are in compliance with stated operating procedures and have sufficient system controls and resiliency. Regulation ATS contains provisions which require operators to conduct periodic independent reviews. But these audits are contingent on the platform exceeding highly liberal volume thresholds which no ATSs currently meet.[9] The SEC has clearly acknowledged this in the Regulation Systems Compliance and Integrity ("SCI") proposal which, lowers the requirements for "SCI alternative trading systems" to more practical levels.[10] BlackRock agrees with this approach and urges regulators to push this forward in order to reverse the deterioration of public trust in ATSs. We believe that Regulation SCI requirements should be further extended to any trading platforms which transact significant volume as these venues have a meaningful role and impact on the equity market. This should include systems which are not required to register as an ATS because all executions are against the bids and offers of a single dealer.[11]

Exchanges should provide investors with greater transparency of exchange order types and modifiers, matching engine logic, order precedence rules, and usage of orders by client segment. Although exchanges do publicly submit proposals for rule changes and new functionality, disclosure around the interaction of complex order types has been insufficient. While some exchanges are starting to voluntarily release this information,

---

[7] A limit order is marketable when the limit price is at or above the lowest offer in the market for a buy order or the limit price is at or below the highest bid in the market for a sell order. Whether a limit order is marketable or non-marketable affects the determination of make/take rebates and fees.

[8] While we appreciate the need to protect proprietary information, any interest in redactions should be balanced against the public interest in the disclosure of ATS procedures relating to order handling, information processing, and data dissemination.

[9] Audits are only required of ATSs that trade 20 percent of the average daily volume of a covered security during at least 4 of the preceding 6 calendar months. *See* 17 CFR 242.301(b)(6)(i) and 17 CFR 242.301(b)(6)(ii)(F).

[10] *See* Proposed Rule 17 CFR 242.1000(a) at 17 FR 18177 (defining "SCI alternative trading system" as a platform which during at least 4 of the preceding 6 calendar months executed 5% or more in any single NMS stock and 0.25% or more in all NMS stocks OR 1% or more in all NMS stocks).

[11] *See* 17 CFR 242.300(a)(1) and 17 CFR 240.3b-16(b)(2).

regulators should require all exchanges to clarify how order types and instructions operate and ensure that available system functionality is clearly documented in the exchange rulebook.[12]

Recent data initiatives by the SEC and FINRA have substantially improved the collective intelligence on equity markets. These platforms do not, however, holistically capture all market activity, and more comprehensive systems, such as the Consolidated Audit Trail, are far from completion. As such, the information which regulators have at their disposal is insufficient for conducting adequate oversight of trading in the equity market. BlackRock believes that steps should be taken in the interim to improve market surveillance and protect the public interest. FINRA Rule 4552 should be expanded to capture all non-exchange trading activity. While FINRA's disclosure requirement has greatly improved transparency of ATS volumes, it is still missing a significant portion of off-exchange activity, such as wholesale market making, broker block facilitation/internalization and executions from single liquidity provider platforms, which are not registered as ATSs. SEC's MIDAS system lacks visibility on non-displayed orders from exchanges and ATSs, usage of order types/modifiers and market participant identifiers. This information is not readily available over existing data feeds. Regulators should work with self-regulatory organizations, ATSs, and market participants to prioritize efforts to expand surveillance of this data. Regulators should also monitor the message traffic from market participants to better understand the nature of this activity and ascertain if it is excessive. Message congestion poses a risk to market stability and needs to be further studied. However, higher volumes of message traffic can be the result of legitimate trading activity, such as market making or cross asset arbitrage. It will be important for regulators to distinguish bona fide trading activity from potential abuses or poorly managed automated trading engines. Enhanced surveillance will enable regulators to assess how best to focus their enforcement and rulemaking efforts to address the underlying determinants of unproductive message traffic.

Reduce Market Structure Complexity

Innovation and competition have led to a more efficient and highly performing US equity market. We recognize that this has also fostered a more complex market where order flow must navigate across multiple trading venues, placing a burden on investors. The ability to place orders on all exchanges comes at a cost which may not be commensurate with the benefits when the likelihood of execution on some venues is very small. The scope of the trade-through rule in Regulation NMS should be reduced to only offer protected quote status to trading venues meeting a minimum market-share threshold. We defer to regulators to determine an appropriate limit which balances the interests of promoting competition with moderating fragmentation, but suggest that venues transacting less than 1% of consolidated trading volume provide limited benefit. Thresholds should be reviewed periodically to ensure that they continue to remain appropriate as market conditions change.

Proliferation in exchange order types has been another key contributor to market complexity. Many order types are designed to comply with regulations or promote

---

[12] Direct Edge commendably published two filings to clarify the operations of their EDGX and EDGA exchanges. These documents highlighted, however, that some of the order instructions available on the exchanges were not defined in the rules. SEC Release No. 34-72676; File No. SR-EDGX-2014-18 and SEC Release No. 34-72812; File No. SR-EDGA-2014-20.

liquidity. However, the interaction between these complex instructions gives rise to a labyrinthine rulebook of order priority and matching engine logic complicating the ability of regulators, exchanges and investors to fully understand the interactions and consequences. Unused or obsolete order types excessively encumber exchange rulebooks and systems while providing limited utility. New order types may disadvantage pre-existing ones by conferring inadvertent benefits beyond their proposed objective.[13] Additionally, discriminatory order types, which avoid trading against incoming orders that are larger or more aggressive, detract from market quality for investors.[14] Regulators and exchanges should conduct a comprehensive review of existing order types to ascertain the extent to which they continue to promote just and equitable principles of trade and if any should be eliminated. Recently, we have observed that exchanges have been clarifying their rules and system functionality. In the process, existing order types have been reclassified as order modifiers or instructions.[15] Although this might be a more appropriate technical categorization of the functionality, market complexity is driven by the manner in which orders behave and interact with each other. This is just as pertinent to the modifiers and instructions which alter order behavior as it is to the types of orders available. Efforts to curtail order complexity should also include a holistic review of the modifiers and instructions which control order behavior.

Ensure Fair Dissemination of Market Data

Equal access to market data is a quintessential principle of fair and orderly markets and a primary goal for regulators. However, the distributed topology of trading venues, plan processors and market data consumers naturally fosters information asymmetry and makes achieving perfect uniformity elusive. While regulators must continue to aspire to parity in market data feeds as a long-term objective, they should focus on minimizing the latency and increasing resiliency of the Securities Information Processors ("SIPs") as an immediate outcome. Exchanges should make the necessary investments in technology to reduce the latency between the SIP and private data feeds to market acceptable standards. At a minimum, SIP performance should be commensurate with that of commercially available market data aggregators. Performance metrics and operating standards must be established to ensure that the SIP continues to receive appropriate funding and support to remain competitive with private aggregation solutions. Exchanges are obligated under Rule 603(a) of Regulation NMS to release data at the same time to the consolidated and proprietary feeds. However, transmission and processing times are heavily influenced by differences in the communication protocols and message formats used after the data is released. SIP infrastructure modernization should also include an evaluation of the technology and protocols used in data transmission.

The NMS Plans should be expanded to permit multiple SIP processors to disseminate consolidated market data instead of relying on a central infrastructure. Centralized platforms discourage innovation and create a single point of failure that poses systemic risk. A network of multiple operators would stimulate competition in price, performance, and system reliability. This would also increase redundancy in the consolidated feed

[13] For example, Day ISO orders can be used to achieve priority in the order book ahead of orders which arrived earlier but could not be displayed due to compliance with Rule 610 of Regulation NMS. This is inconsistent with the original aim of helping institutions to sweep and subsequently post at a price level.

[14] *See* Market Structure *ViewPoint* at 6 (describing the harmful uses of some specific order types).

[15] SEC Release No. 34-72676; File No. SR-EDGX-2014-18 and SEC Release No. 34-72812; File No. SR-EDGA-2014-20.

which is a critical market utility, as observed by the NASDAQ market outage on August 22, 2013.[16]

Exchanges should synchronize their timestamps and ensure that they are accurate to the microsecond. Exchange clocks are not consistent with each other and the timestamps that they generate exhibit different levels of precision. This makes it difficult to properly sequence the events which occur across multiple trading venues. Market data consolidators address this issue by assigning timestamps at the point when information is received, but the resulting picture is not a true representation of the market and cannot be used in a meaningful way to analyze sub-second event horizons. Technology has elevated the role of speed in equity markets. In a recent SEC speech, it was noted that 23% of cancellations and 19% of trades occur within a 50 millisecond timeframe.[17] Although this is a minority of overall trading activity, it does highlight that investors and regulators increasingly need to conduct analysis at high-frequency intervals. Accurate and consistent exchange timestamps are an integral component to enabling investors to understand the market and regulators to oversee it.

Conclusion

The US equity market is not broken or in need of large scale change. Public interest will be best served by targeted changes that enhance existing rules and practices. BlackRock has outlined a set of proposals that we believe will restore public confidence and foster fair, orderly and efficient markets for all investors. We thank the Commission for this opportunity to put forward our recommendations on a number of significant issues for policymakers. We would be pleased to assist and engage in continued dialogue on any of these topics. Please do not hesitate to contact us if you have comments or further questions regarding BlackRock's perspective.

Sincerely,

Richie Prager
Managing Director, Head of Trading & Liquidity Strategies

Hubert De Jesus
Managing Director, Co-Head of Market Structure & Electronic Trading

Supurna Vedbrat
Managing Director, Co-Head of Market Structure & Electronic Trading

Joanne Medero
Managing Director, Government Relations & Public Policy

---

[16] On that date, an outage of the SIP for NASDAQ listed securities led to a 3 hour halt in trading.

[17] Gregg Berman, What Drives the Complexity and Speed of our Markets? Speech at the North American Trading Architecture Summit (April 15, 2014) (available at http://www.sec.gov/News/Speech/Detail/Speech/1370541505819#).