



# BETTER MARKETS

April 18, 2022

Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: Amendments to Exchange Act Rule 3b-16 Regarding the Definition of “Exchange”; Regulation ATS for ATSS That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSS That Trade U.S. Treasury Securities and Agency Securities (File No. S7-02-22, RIN 3235-AM45); 87 Fed. Reg. 15,496 (Mar. 18, 2022)

Dear Ms. Countryman:

Better Markets<sup>1</sup> appreciates the opportunity to comment on the above-captioned Proposed Rule (“Proposal” or “Release”)<sup>2</sup> issued by the Securities and Exchange Commission (“SEC” or “Commission”). The Proposal has several important components, two of which are re-proposals from the Commission’s 2020 proposal<sup>3</sup> with certain revisions. The two re-proposals would collectively eliminate the exemption for Government Securities alternative trading systems (“ATSS”) from Regulation ATS. They would also require those ATSS to file Form ATS-N and comply with the Fair Access Rule and Regulation SCI if they trade significant volume. In addition, the Proposal would expand the scope of Rule 3b-16, which implements the statutory definition of “exchange” under the Securities Exchange Act (“Exchange Act”), to include Communication Protocol Systems. Finally, the Proposal would require the disclosure of additional information in all Form ATS-Ns.

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<sup>1</sup> Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans’ jobs, savings, retirements, and more.

<sup>2</sup> Amendments to Exchange Act Rule 3b-16 Regarding the Definition of “Exchange”; Regulation ATS for ATSS That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSS That Trade U.S. Treasury Securities and Agency Securities, 87 Fed. Reg. 15,496 (Mar. 18, 2022).

<sup>3</sup> Regulation ATS for ATSS That Trade U.S. Government Securities, NMS Stock, and Other Securities; Regulation SCI for ATSS That Trade U.S. Treasury Securities and Agency Securities; and Electronic Corporate Bond and Municipal Securities Markets, 85 Fed. Reg. 87,106 (Dec. 31, 2020).

The Proposal represents another important enhancement and incremental step in the oversight of ATSS. The Proposal appropriately updates Rule 3b-16 to encompass the rapidly evolving nature of electronic trading venues in the form of Communication Protocol Systems; extends Regulation ATS, as well as the Fair Access Rule and Regulation SCI, to Government Securities ATSS; and generally fortifies the oversight of all ATSS. However, the Proposal further entrenches the bifurcated regulation of similarly functioning entities in the securities markets. Once the Proposal is finalized, registered exchanges will continue to be subject to far more robust regulation than ATSS, as ATSS will continue to be exempt from many of those requirements. At a minimum, the Commission must strengthen the Proposal to apply Regulation ATS equally to ATSS that trade all forms of securities. And it must examine additional ways to further close the regulatory gap between exchanges and ATSS. Only then will the Commission be able to fully protect investors seeking appropriate venues for their securities trades.

## **BACKGROUND**

When Congress passed and President Franklin Delano Roosevelt signed the Securities Exchange Act of 1934, it delegated to the newly created Securities and Exchange Commission the authority to facilitate the establishment of a national market system for securities to protect investors and maintain fair and orderly markets. The regulation of exchanges was a central component of that new framework.<sup>4</sup> The term “exchange” in the Exchange Act is defined to mean:

“any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.”<sup>5</sup>

Congress intentionally adopted this broad definition to enable the Commission to adapt to changes in the markets.<sup>6</sup> Section 5 of the Exchange Act requires those that meet the statutory definition of exchange to register with the Commission as a national securities exchange. Over time, technological advancements in broker-dealer activities increasingly blurred the lines between the functions of a broker-dealer and those of an exchange.<sup>7</sup>

With the passage of the National Securities Markets Improvement Act of 1996,<sup>8</sup> the Commission received increased authority from Congress to exempt persons from the requirements of the Exchange Act. In May 1997, the Commission issued a concept release to address the evolving nature of trading platforms gaining prevalence in the markets, which in turn led to the

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<sup>4</sup> 15 U.S.C. § 78k-1(a).

<sup>5</sup> 15 U.S.C. § 78c(a)(1).

<sup>6</sup> S. Rep. No. 73-792, at 5 (1934) (noting that “exchanges cannot be regulated efficiently under a rigid statutory program”).

<sup>7</sup> Release at 15,499.

<sup>8</sup> Regulation of Exchanges, 62 Fed. Reg. 30,485 (June 4, 1997).

adoption of Regulation ATS.<sup>9</sup> In 1998, the Commission used its exemptive authority to adopt Regulation ATS, which sought specifically to address the growth of ATSS being operated by broker-dealers that provided many of the same services offered by national market securities exchanges.<sup>10</sup> The Commission's new Regulation ATS exempted registered broker-dealers operating a trading platform from registration as a national securities exchange as long as they simply disclosed certain basic, nonpublic information on Form ATS and filed it with the Commission. At the time the rule was finalized, securities being traded by broker-dealers on ATSS represented 20 percent of orders listed on the Nasdaq and nearly four percent of orders in exchange listed securities.<sup>11</sup>

The decision by the Commission to bifurcate the regulation of platforms that operate under the Exchange Act's definition of exchange has been fundamentally flawed since its inception. As alternative trading venues began to approach the scale of trading services, trading volume, and complexity that is typical of the exchanges, the Commission could have designed a regulatory framework that created a level playing field between exchanges and ATSS. Instead, they elected to allow ATSS to perform all the essential functions of exchanges with substantially less oversight.

Three core problems grew out of this approach. First, the equity markets became less transparent. As a result, market participants increasingly struggled to identify the venues with the best order execution quality, and market efficiency suffered accordingly. Second, competitive imbalances among and between functionally similar trading centers—ATSS and exchanges—grew. And third, conflicts of interest arising from the operational complexities of ATSS, including the dual roles of the broker-dealer as ATS operator and broker, proliferated while remaining invisible to investors.

A number of ATS enforcement cases illustrate the opaque nature of these conflicts of interest and how they pose a serious threat to investors. For example, in 2011, the Commission brought an enforcement action against Pipeline Trading Systems for publicly representing that no proprietary trading took place in its dark pool. But in fact, not only did one of the firm's affiliates engage in proprietary trading in the pool, it secretly used confidential information to front-run its subscribers' trades.<sup>12</sup> In another example, the Commission sanctioned Investment Technology Group, Inc. for failing to disclose that its proprietary trading desk was trading within its pool and enjoying certain informational advantages over other subscribers.<sup>13</sup> And in yet another example, the Commission took enforcement action against UBS Securities LLC for offering high-speed traders special order types that gave them an advantage over other classes of subscribers.<sup>14</sup>

In an effort to address some of the bad actors in the space, the Commission adopted its first substantive update to Regulation ATS in 2018, which imposed wide-ranging new disclosure

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<sup>9</sup> National Securities Markets Improvement Act of 1996, 15 U.S.C. 78a.

<sup>10</sup> Regulation of Exchanges and Alternative Trading Systems, 63 Fed. Reg. 70,844 (Dec. 22, 1998).

<sup>11</sup> *Id.* at 70,845.

<sup>12</sup> See Pipeline Trading Systems LLC, Fred J. Federspiel, and Alfred R. Berkeley III, No. 9271 (Securities and Exchange Commission Oct. 24, 2011).

<sup>13</sup> ITG Inc. and Alternet Securities Inc., No. 75672 (Securities and Exchange Commission Aug. 12, 2015).

<sup>14</sup> UBS Securities LLC, No. 74060 (Securities and Exchange Commission Jan. 15, 2015).

requirements on ATSS that transact in National Market System (“NMS”) stocks.<sup>15</sup> The extensive level of disclosure required under the rule and the role it envisioned for the Commission in reviewing and ultimately approving the design and operations of NMS Stock ATSS was a recognition of the exchange-like nature of NMS Stock ATSS. The rule more closely aligned the regulation of NMS Stock ATSS with the way in which national securities exchanges are regulated. During the first quarter of 2018, NMS Stock ATSS accounted for 11.4 percent of the combined total share trading volume in NMS stocks on securities exchanges.<sup>16</sup> However, despite the rule’s improvement to the status quo, the rule failed to incorporate several key reforms. For example, it failed to expand the Regulation ATS requirements to ATSS trading other types of securities such as Treasury bonds (a reform advocated by Better Markets during the notice and comment period).

In September 2020, the Commission issued another proposal to extend Regulation ATS to Government Securities ATSS. Specifically, the proposal would have eliminated the exemption from compliance with Regulation ATS that applies to ATSS trading government securities; required Government Securities ATSS to file new Form ATS-G; and required Government Securities ATSS to comply with Rule 301(b)(5), known as the Fair Access Rule, as well as Reg SCI. The 2020 release also included a concept release on electronic fixed income trading platforms.<sup>17</sup> The concept release was included in the proposal to explore possible additional regulation of Communication Protocol Systems as exchanges, based on recommendations from the Fixed Income Market Structure Advisory Committee (FIMSAC) to examine these regulatory gaps.<sup>18</sup> Formed to examine the increasing use of electronic trading in the corporate and municipal bonds markets, the FIMSAC recommended that the Commission, FINRA, and the Municipal Securities Rulemaking Board review the regulatory framework for oversight of electronic trading platforms for corporate and municipal securities. Specifically, they recommended a review to examine regulatory gaps and inconsistencies in the regulation of various platforms and to consider whether Regulation ATS should be amended to reach platforms that traded fixed income securities.<sup>19</sup> The current Proposal is a natural outgrowth of the 2020 proposal, and it incorporates the views of some commenters who urged the SEC to make the 2020 proposal stronger and reduce regulatory gaps.

## **OVERVIEW OF THE PROPOSAL**

The Commission has proposed several new rules and rule amendments that govern the definition of an “exchange” and Regulation ATS under the Exchange Act.

- First, the Proposal would amend Exchange Act Rule 3b-16, which defines “exchange,” to include systems that convey non-firm trading interest and

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<sup>15</sup> Regulation of NMS Stock Alternative Trading Systems, 83 Fed. Reg. 38,768 (Aug. 7, 2018).

<sup>16</sup> 83 Fed. Reg. 38,768, 38,770.

<sup>17</sup> 85 Fed. Reg. 87,106.

<sup>18</sup> *Id.* at 87,157.

<sup>19</sup> Fixed Income Market Structure Advisory Commission, Recommendation for the SEC to review the Framework for the Oversight of Electronic Trading Platforms for Corporate and Municipal Bonds (July 16, 2018).

Communication Protocol Systems that offer buyers and sellers a platform to communicate, negotiate, and agree to terms of trading securities.

- Second, the Proposal would expand the requirements of Regulation ATS to all ATSs that trade Government Securities. Specifically, this component of the proposal would:
  - eliminate the exemption for ATSs that trade only government securities or repurchase agreements of government securities from compliance with Regulation ATS;
  - require compliance with the Fair Access Rule for Government Securities ATSs that traded three percent or more of the average weekly dollar volume for U.S. Treasury Securities, or five percent or more of the average daily dollar volume traded for Agency securities in the U.S., in at least four of the preceding six calendar months;
  - require Government Securities ATSs to comply with enhanced disclosure and filing requirements under Rule 304; and
  - require Government Securities ATSs to file Form ATS-N.
- Third, the Proposal would require Government Securities ATSs to comply with the requirements of Reg SCI if they traded five percent or more of the average daily dollar volume for either U.S. Treasury Securities or Agency Securities traded in the U.S. in at least four of the preceding six calendar months.
- Finally, the Proposal would amend Form ATS-N and its review by the Commission in several ways, specifically to require—
  - disclosure of an ATS’s potential conflicts of interests with related markets and liquidity providers, and disclosure of activities the ATS undertakes to surveil and monitor its market for both Government Securities ATSs and NMS Stock ATSs;
  - existing NMS Stock ATSs to file an amendment to existing disclosures;
  - reporting of changes to fee disclosures;
  - enhancements in the review and effectiveness process for Form ATS-N by the Commission; and
  - electronic filing of Form ATS-R and Form ATS-N on EDGAR.

## **COMMENTS**

The Commission’s Proposal is appropriate and necessary. Notably, it appropriately adapts the definition of “exchange” to include Communication Protocol Systems and eliminates the exemption for Government Securities ATSS from compliance with Regulation ATS. These changes, along with others in the Proposal, will help the Commission’s regulatory framework keep pace with the increased use of electronic trading venues and innovations in facilitating the purchasing and selling of securities in our markets. The Proposal will move our regulatory regime another step closer to full transparency, fair competition, and above all, stronger investor protections in the realm of exchanges, ATSS, and the associated activities of their broker-dealer operators. The Commission should finalize the Proposal, subject to the recommendations we set forth below.

### **I. The Proposal’s classification of Communication Protocol Systems as exchanges is consistent with the language and intent of the Exchange Act’s definition of “exchange.”**

The Proposal appropriately requires newly defined Communication Protocol Systems to comply with enhanced regulatory oversight, either by registering as an exchange or being subject to Regulation ATS. Under the current regulatory framework, Communication Protocol Systems do not fall within the regulatory definition of an exchange nor are they regulated under Regulation ATS. As the Commission correctly explains, this regulatory disparity between market participants “can create a competitive imbalance and a lack of investor protections.”<sup>20</sup> Specifically, the Commission highlights one form of Communication Protocol System that has seen increased usage as an electronic trading platform in recent years, the Request-for-Quote (RFQ) protocol. The Commission notes that fixed income trading on RFQ protocols “increased from \$223 million in the second quarter of 2017 to \$1.17 billion in the second quarter of 2021.”<sup>21</sup> Additionally, the Commission notes that RFQ protocols account for approximately 50 percent of total electronic trading volume in the dealer-to-customer segment of the U.S. Treasury market.<sup>22</sup> Moreover, the FIMSAC identified the disparate regulatory treatment in the corporate and municipal bond markets as an issue for the Commission to examine in 2018, specifically highlighting that electronic RFQ platforms are excluded from Regulation ATS, based on their unique characteristics.<sup>23</sup>

The Proposal would help address this inconsistent regulatory approach by, for example, applying enhanced oversight and regulation to RFQ protocols. More generally, it would enable the Commission to keep pace with technological innovations occurring in the markets. When the Commission adopted Regulation ATS in 1998, it noted that market participants had adopted technological advances that the current regulatory framework did not envision when the Exchange

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<sup>20</sup> Release at 15,498.

<sup>21</sup> Release at 15,501.

<sup>22</sup> *Id.*

<sup>23</sup> Fixed Income Market Structure Advisory Commission, Recommendation for the SEC to review the Framework for the Oversight of Electronic Trading Platforms for Corporate and Municipal Bonds (July 16, 2018).

Act was adopted more than six decades earlier.<sup>24</sup> The same is true today, as reflected in the Commission’s Proposal to bring Communication Protocol Systems under the definition of an exchange and regulate them as such or require them to register as an ATS.

This treatment of Communication Protocol Systems is fully consistent with both the text and the underlying purposes of the Exchange Act. As cited above, the statutory definition of “exchange” under the Exchange Act is—

“any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.”<sup>25</sup>

It is clear from this broad statutory definition that any platforms or protocols that provide a marketplace for the purchasing and selling of any security fall under the definition of an exchange. Rule 3b-16’s current, more narrow requirement that platforms must facilitate “orders” and established, non-discretionary methods of trading to be considered as an exchange reflected how most ATSS operated at the time the rule was adopted.<sup>26</sup> The increased use of electronic trading venues and related innovations in the purchasing and selling of securities have enabled markets and market participants to trade securities in new ways not envisioned at the time of the adoption of Rule 3b-16. As discussed above, for example, the increased use of RFQ protocols to trade fixed income securities has enabled the purchasing and selling of securities without firm orders; those platforms are more akin to auctions where the expression of non-firm trading interest can facilitate the negotiation and execution of trades.<sup>27</sup> The Proposal correctly adapts Rule 3b-16 to keep pace with this and other innovations in the markets that facilitate the purchasing and selling of securities. This approach is squarely in line with the plain text of the Exchange Act.

Further, the expanded interpretation by the Commission of the definition of “exchange,” to incorporate Communication Protocol Systems is fully consistent with the intent of the Exchange Act. In Senate report language accompanying its passage, the authors of the text stated:

“From the outset, [The Committee on Banking and Currency] has proceeded on the theory that so delicate a mechanism as the modern stock exchange cannot be regulated efficiently under a rigid statutory program. Unless considerable latitude is allowed for the exercise of administrative discretion, it is impossible to avoid, on the one hand, unworkable ‘strait-jacket’ regulation and, on the other, loopholes which may be penetrated by slight variations in the method of doing business. Accordingly it is essential to entrust the administration of the act to an agency

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<sup>24</sup> 63 Fed. Reg. 70,844, 70,845.

<sup>25</sup> 15 U.S.C. § 78c(a)(1).

<sup>26</sup> 85 Fed. Reg. 87,106, 87,137 (Dec. 31, 2020).

<sup>27</sup> Release at 15,500.

vested with power to eliminate undue hardship and to prevent and punish evasion.”<sup>28</sup>

This expression of Congressional intent is clear. The Commission was granted broad authority and considerable “latitude” to accommodate anticipated evolution in the securities markets and to prevent loopholes that would facilitate evasion through variations in the methods of conducting business. As the Commission now finds, Communication Protocol Systems are clearly performing the same core market functions that exchanges and ATSS perform, notwithstanding the “variations” in platform design—they bring together buyers and sellers of securities on their platforms.<sup>29</sup> It is within the Commission’s administrative discretion, and indeed its duty, to ensure entities operating as exchanges, regardless of their variations, by connecting buyers and sellers of securities are subject to the requirements of the Exchange Act. This clearly includes Communication Protocol Systems. The Commission’s Proposal to include Communication Protocol Systems in the definition of an exchange, thereby bringing them within the exchange or Regulation ATS framework, is in furtherance of the Commission’s mission to protect investors, ensure fair and orderly markets, and facilitate capital formation.

As the Commission considers commenters’ views and finalizes the Proposal, it must not be dissuaded from applying the broad statutory definition of an exchange to a variety of emerging platforms that function as exchanges. For example, the cryptocurrency industry is rapidly expanding with some industry lobbyists insisting that their offerings and platforms fall outside the securities laws and regulations. But clearly, the Commission must apply securities regulation equally to all securities regardless of how novel, “innovative,” popular, or profitable such offerings may be. Indeed, because of those attributes, the Commission must ensure that the investor protection and market stability concerns often presented by those offerings are addressed through regulation. This Proposal should be no different.

Chairman Gensler has correctly explained on several occasions that many cryptocurrencies almost certainly fall under the definition of a security.<sup>30</sup> Likewise, Chairman Gensler has noted recently that the five largest platforms that facilitate the purchasing and selling of those securities make up 99 percent of all such trading and likely facilitate the trading of more than 100 digital asset tokens.<sup>31</sup> These platforms that facilitate hundreds of billions of dollars in securities trading,

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<sup>28</sup> S. Rep. No. 73-792, at 5 (1934).

<sup>29</sup> Release at 15,498.

<sup>30</sup> Gary Gensler, Chairman, SEC, Remarks Before the Aspen Security Forum (Aug. 3, 2021) (“many of these tokens are offered and sold as securities...these products are subject to the securities laws and must work within our securities regime”); Gary Gensler, Chairman, SEC, Interview with CNBC, (Jan. 10, 2022) (“...if they call themselves a token, they are still probably, possibly a security”); Gary Gensler, Chairman, SEC, Prepared Remarks of Gary Gensler on Crypto Markets, Penn Law Capital Markets Association Annual Conference (Apr. 4, 2022) (“The [BlockFi] settlement made clear that crypto markets must comply with time-tested securities laws”).

<sup>31</sup> Gary Gensler, Chairman, SEC, Prepared Remarks of Gary Gensler on Crypto Markets, Penn Law Capital Markets Association Annual Conference (Apr. 4, 2022).

largely to retail investors, absolutely should be subject to the requirements relating to exchanges under the Exchange Act.<sup>32</sup>

In fact, the core challenge facing the Commission is not whether platforms offering trading in cryptocurrency securities should be regulated but whether they should be subject to the more robust oversight applicable to exchanges rather than the more limited regulation that comes with registrations as an ATS. ATSS evolved largely to accommodate sophisticated institutional investors seeking a price-stable environment in which to trade large blocks of securities. Yet many of the emerging trading platforms, including cryptocurrency exchanges, are heavily focused on attracting retail investors. While ATSS operating under Regulation ATS are not prohibited from serving retail traders, it appears inappropriate to allow these exchanges the benefit of the Regulation ATS exemption due to their focus on retail trading volume. Typically, but not always, ATSS provide institutional investors who are investing large sums of money with an alternative trading venue other than an exchange. Thus, a lighter regulatory regime may be more appropriate for institutional investors that have more expertise and resources, equipping them to better protect themselves from fraud and manipulation. Unlike ATSS, cryptocurrency exchanges provide mostly retail traders the ability to trade cryptocurrencies, thus calling for stronger regulation as an exchange. Exchange status entails acting as an SRO, establishing listing requirements, requiring market surveillance, and adopting enforcement mechanisms. In short, it is not clear that retail customers who trade directly with cryptocurrency exchanges would be best served by affording these platforms the opportunity to comply only with the lighter regulatory regime that is Regulation ATS.<sup>33</sup>

As shown above, Congress gave the Commission broad authority to regulate platforms that facilitate the purchasing and selling of securities. Any organization, association, or group of persons that facilitates the purchasing and selling of securities on their platform should fall under the definition of an exchange and register with the Commission, unless an exemption such as Regulation ATS is appropriate. And the Commission should not be swayed by the often-hyperventilated arguments from those commenters representing the cryptocurrency industry and their apparent sense of entitlement to a perpetual regulatory sandbox or immunity.

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<sup>32</sup> See The Block, Spot Markets: Fiat Exchange Volume (Apr. 14, 2022), <https://www.theblockcrypto.com/data/crypto-markets/spot> (Fiat exchange volume for March 2022 was \$303.71 billion).

<sup>33</sup> Additionally, application of the Fair Access Rule and Reg SCI under Regulation ATS are based on volume thresholds, which is information collected and held by self-regulatory organizations such as FINRA and the MSRB. It is unclear how application of these rules, which are based on volume thresholds, would apply to cryptocurrency exchanges that do not report to self-regulatory organizations. Despite this challenge, the Commission should consider avenues to apply the Fair Access Rule and Reg SCI to cryptocurrency exchanges, especially because of their reliance on technical capacity, systems, and integrity in addition to the high number of retail customers utilizing their platforms. These are questions the Commission should address in its final rule.

## **II. The Proposal will enhance oversight and investor disclosure protection in the Government Securities market by bringing it under the Regulation ATS regulatory framework.**

The Proposal will bring much needed oversight and investor disclosure to the \$21 trillion Treasury securities market and the \$10.1 trillion Agency- and GSE-backed securities markets. These markets, collectively known as the government securities markets, make up roughly 95% of the fixed income trading volume in the U.S. on any given day.<sup>34</sup> Eliminating the exemption for government securities from compliance with Regulation ATS, specifically compliance with Rule 304, the Fair Access Rule, and Reg SCI, is long overdue.

The decision to preserve the exemption from Regulation ATS compliance for government securities, namely Treasury securities and Agency- and GSE-backed securities, was a missed opportunity back in 2018. During that rulemaking, the Commission refused to extend Reg ATS protections to Government Securities ATSS despite urging from commenters.<sup>35</sup> Specifically, the Commission decided in favor of taking an incremental approach before extending Reg ATS to government securities with a commitment to monitor the implementation and effectiveness of the 2018 rule. However, the increased electronic trading of these securities, in combination with the sheer volume of trading on these ATSS, makes it critical that the Commission extend Reg ATS to Government Securities ATSS.

The U.S. Treasury market is the largest and most liquid bond market in the world, and much of the global financial system relies on this market to function properly. Despite its importance, ATSS that trade government securities, including Treasury securities, are largely exempt from the regulatory oversight of Regulation ATS. This regulatory gap in one of the most important bond markets in the world helped contribute to several liquidity crises over the past decade, including the 2014 flash rally, the 2019 repo market pressures, the 2020 COVID market disruptions, and the 2021 flash rally.<sup>36</sup> It is far past time for the Commission to address this regulatory gap, which invites abuse.

In 2020, the Commission announced a settlement with JPMorgan Chase & Co. for “fraudulently engaging in manipulative trading of U.S. Treasury securities.”<sup>37</sup> According to the Commission’s Order, traders at JPMorgan Chase submitted multiple orders to buy certain Treasury

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<sup>34</sup> Release at 15,595.

<sup>35</sup> 83 Fed. Reg. 38,768, 38,783 (A wide range of industry and investor advocate commenters supported the extension of Reg ATS to Government Securities ATSS, including Better Markets, Virtu, CFA Institute, Citadel, and MFA/AIMA).

<sup>36</sup> *See e.g.* U.S. Department of Treasury et al., Recent Disruptions and Potential Reforms in the U.S. Treasury Market: A Staff Progress Report (Nov. 8, 2021), <https://home.treasury.gov/system/files/136/IAWG-Treasury-Report.pdf>; *See* Annette Vissing-Jørgensen, Bank for International Settlements, The Treasury market in spring 2020 and the response of the Federal Reserve (Oct. 2021), [bis.org/publ/work966.pdf](https://bis.org/publ/work966.pdf); *See* Alex Aronovich, Dobrislav Dobrev, and Andre Meldrum, The Treasury market Flash Event of February 25, 201, FEDS Notes, Washington: Board of Governors of the Federal Reserve (May 14, 2021), <https://doi.org/10.17016/2380-7172.2909>.

<sup>37</sup> Press Release, SEC, J.P.Morgan Securities Admits to Manipulative Trading in U.S. Treasuries (Sept. 29, 2020).

cash securities from opposite sides of the market to create a false appearance of buy or sell interest to secure more favorable prices.<sup>38</sup> Coupled with parallel announcements by the U.S. Department of Justice and Commodity Futures Trading Commission, JPMorgan Chase entered into a deferred prosecution agreement with the Justice Department and agreed to pay criminal restitution, forfeiture, disgorgement, penalties, and fines of more than \$920 million.<sup>39</sup> This further illustrates that the government securities market is in desperate need of more robust oversight and regulatory safeguards.

The Proposal is an important step toward bringing greater transparency, more fair competition, and above all, stronger investor protections to the government securities markets and the associated activities of their broker-dealer operators. The required disclosures in Rule 304 for Form ATS-N for government securities will appropriately cover the activities of broker-dealers and their affiliates, resulting in greater insight for investors on ATS trading services, fees, conflicts of interest, market data, order types, and trading algorithms. Moreover, requiring Government Securities ATSS that trade a sufficient volume of securities to comply with the Fair Access Rule and Reg SCI is an appropriately tailored reform to help ensure fair and orderly markets and system integrity.

### **III. The Proposal will enhance the capacity, stability, and integrity of the government securities markets by subjecting the most active ATSS to Reg SCI.**

The Proposal correctly subjects Government Securities ATSS to Regulation SCI, which will help protect the technical capacity, system stability, and operational integrity of those markets. Subjecting the Government Securities ATSS to Reg SCI will strengthen the infrastructure and resiliency of the Treasury securities market, in particular, and help to address the increased risks posed by automation in that market.

Regulation SCI was intended to help prevent and mitigate system-related disasters by amending the current voluntary program and requiring self-regulatory organizations, alternative trading systems, plan processors, and exempt clearing agencies to adopt comprehensive policies and procedures governing their technological systems. Under Regulation SCI, these market participants must adhere to a set policies and procedures requiring annual reviews of system risks and assessments of internal controls. Additionally, the regulation enhanced Commission supervision through certain notification and reporting requirements.

The Commission initially adopted Reg SCI in 2014 for a number of reasons, including the increased dependency of markets and market participants on sophisticated, complex, and interconnected technologies and operating systems.<sup>40</sup> Additionally, recent market events had made

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<sup>38</sup> J.P.Morgan Securities LLC, No. 3-20094, 2 (Securities and Exchange Commission. 29, 2020).

<sup>39</sup> Press Release, *supra* note 34.

<sup>40</sup> Regulation Systems Compliance and Integrity, 79 Fed. Gov. 72,252, 72,253 (Dec. 5, 2014) (“These considerations include: the evolution of the markets to become significantly more dependent upon sophisticated, complex and interconnected technology; the current successes and limitations of the ARP Inspection Program; a significant number of, and lessons learned from, recent systems issues at exchanges

the need for Reg SCI abundantly clear. For example, on May 6, 2010, the markets inexplicably and without warning experienced extreme fluctuations, where major indices plummeted almost \$1 trillion in minutes before partially rebounding and over 20,000 trades were executed at prices more than 60 percent away from their market values. It was not until over four months later that these market events, now known euphemistically as the Flash Crash, were analyzed by the SEC and the Commodity Futures Trading Commission, which concluded that the turmoil resulted from one institutional investor's use of a flawed trading algorithm.

These high-profile events involving systems-related issues in the equity markets, combined with the increasing reliance on technical systems in trading equities that led to the adoption of Reg SCI in 2014 in the first place, have strong parallels in the government securities markets. They too have experienced recent disruptions in the markets<sup>41</sup> and they increasingly rely on technical systems as well. It is therefore necessary and appropriate to apply the safeguards under Reg SCI to these markets. The Proposal will help address the risks posed by increased automation in Government Securities ATSS and strengthen the infrastructure and resiliency of the Treasury securities market, in particular, which serves as one of the pillars of the global financial system.

#### **IV. The Proposal should be strengthened by requiring clear and explicit disclosure of all permitted conflicts of interest for all ATSS and banning material conflicts of interest.**

The Proposal will undoubtedly be useful to investors who seek to learn more about the potential conflicts of interest that can arise when the business interests of a broker-dealer operator or its affiliates clash with the interests of market participants that trade on Government Securities ATSS. Such conflicts represent a significant and growing area of concern for investors. The Commission is to be commended for requiring disclosure of these conflicts. As a result, market participants will be better equipped to assess whether they are trading on a level playing field with other subscribers or instead likely to fall victim to abusive and unfair practices. Although the Proposal contains these constructive provisions aimed at illuminating conflicts of interest, the Commission should strengthen the Proposal to require clear and explicit disclosure of all permitted conflicts of interests for all ATS and ban all *material* conflicts of interest entirely.

Under current Regulation ATS, NMS Stock ATSS are required to disclose potential conflicts of interest that may arise from the structure and functions of the Covered ATS and ATS-related activities in Form ATS-N.<sup>42</sup> For example, a conflict of interest may arise between the broker-dealer operator and another market participant with respect to preferential routing

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and other trading venues, increased concerns over 'single points of failure' in the securities markets; and the views of a wide variety of commenters received in response to the SCI Proposal").

<sup>41</sup> See U.S. Department of Treasury et al., Recent Disruptions and Potential Reforms in the U.S. Treasury Market: A Staff Progress Report (Nov. 8, 2021), <https://home.treasury.gov/system/files/136/IAWG-Treasury-Report.pdf> (Section 3 describes recent disruptions in the Treasury market, including March 2020 COVID-19 disruptions; October 15, 2014, flash rally; September 2019 repo market pressures; and February 25, 2021 high trading volumes).

<sup>42</sup> See 17 C.F.R. § 242.304.

arrangements and routing arrangements with affiliates.<sup>43</sup> Under the Proposal, the Commission would require Government Securities ATSS to disclose similar potential conflicts of interest in Form ATS-N. While extending the requirement to disclose potential conflicts of interest to Government ATSS, so that it parallels the current requirement for NMS Stock ATSS, is clearly appropriate, the Proposal can and should go further in two respects.

First, the Commission should strengthen the disclosure provision to require clear and explicit disclosure of all permitted conflicts of interests for all ATSS. This is necessary to help investors more completely identify conflicts of interests. The Proposal requires the disclosure of considerable volumes of information, and many of the ingredients of common conflicts of interest will be embedded in that information. But the Proposal does not actually require clear disclosure of conflicts as such. While it is beneficial to require ATSS to actually spell out the details of the form that a conflict of interest may take, this disclosure scheme would be much more useful if it required the explicit disclosure of conflicts as conflicts—perhaps in a section of the form entitled “Conflicts of Interest”—in a simple, plain, and clear format.

Second, where a material conflict of interest exists, the Proposal should ban such conflicts. Similar to the original proposal to require disclosure of conflicts of interests in its 2018 rule, the Proposal offers little solace to those who are concerned that disclosure alone is insufficient to prevent conflicts from harming investors. Accordingly, the Commission should strengthen the Proposal by actually banning material conflicts of interest that may arise between an ATS and its affiliates, rather than relying on disclosure alone to generate conflict-reducing market incentives. Material conflicts of interest should not be tolerated, and no amount of disclosure can provide the necessary protection for investors against such conflicts.

Helping investors cope with damaging real and potential conflicts of interest appears to be a primary aim of the Proposal. The best way to achieve this end is by simply creating a flat, enforceable bar against clear and material conflicts of interest. At the very least, disclosure regarding any permitted conflicts of interest must be more explicit, including summary disclosure of conflicts as conflicts.

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<sup>43</sup> Release at 15,546, n. 547 (“In the NMS Stock ATS Adopting Release, the Commission provided examples of when potential conflicts of interest and information leakage could occur as a result of preferential routing arrangements (e.g., an affiliate is contractually obligated to route all unexecuted orders to ATS) or routing arrangements with affiliates (e.g., all orders routed by the NMS Stock ATS must first be routed to an affiliate(s)). Specifically, the former might result in information leakage should the arrangement provide that all orders not executed by the affiliate are to be sent to the NMS Stock ATS and the latter could provide an incentive for the NMS Stock ATS to route orders to an affiliate instead of trying to execute the order in the ATS. These issues could arise in the government securities markets, as well, so those examples are also applicable to both NMS Stock ATSS and Government Securities ATSS”).

**V. The Proposal should extend current Regulation ATS requirements for NMS Stock ATs and proposed requirements for Government Securities ATs to all securities, including corporate, municipal, and non-NMS equities.**

As mentioned above, the Proposal correctly extends the requirements of Regulation ATS to Government Securities ATs, but the same arguments the Commission makes in the Proposal for extending Regulation ATS to government securities also applies to all other ATs, including corporate, municipal, and non-NMS equities.<sup>44</sup> Specifically, the Commission should apply Rule 304 of Regulation ATS to all ATs and Communication Protocol Systems. In addition, it should lower the thresholds for compliance with Rule 301(b)(6), otherwise known as Reg SCI, for corporate and municipal securities from 20 percent to five percent. The Proposal would be significantly strengthened if all ATs that trade any security had to comply with Rule 304 and Reg SCI equally.

Conceptually, this is the right approach. All investors in securities deserve equally robust protections, including access to transparent information about conflicts of interest and other aspects of their trading venues. And all market participants should be able to conduct their businesses on a level regulatory playing field, again regardless of the types of securities trading they seek to offer to investors. Extending the enhanced protections of the Proposal, as modified in accordance with these comments, to all types of ATs is also the optimal regulatory policy from a pragmatic point of view. Lax or piecemeal regulation cannot be justified with arguments to the effect that trading in certain securities is sparse and that we should allow for innovation in those markets before adopting more effective regulatory measures. This approach is simply delaying the inevitable while in the meantime allowing investors to be needlessly victimized and market participants to be needlessly burdened with unfair disparities in regulatory treatment. The best course is to move forward with broad-based reforms as to all ATs, in fulfillment of the SEC's overarching duty to protect investors and ensure the integrity of the marketplace.

**CONCLUSION**

We hope these comments are helpful as the Commission finalizes the Proposal.

Sincerely,



Stephen W. Hall  
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<sup>44</sup> See also Release at 15,497 (“To promote operational transparency, investor protection, system integrity, fair and orderly markets, and regulatory oversight...”).

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