

June 13, 2022

Via Electronic Mail

Vanessa Countryman, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Re: File No. S7-02-22; 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<sup>1</sup>

Dear Ms. Countryman:

The Healthy Markets Association<sup>2</sup> writes to support and offer recommendations to improve the above-referenced Proposal to revise the rules for some ATSS and revise the definition of “exchange.”

## Background

Securities trading venues – whether exchanges, alternative trading systems (ATSS), or broker-dealer internalizers – may have conflicts of interest, as well as governance and operational practices, that present risks to investors and markets. The registration and oversight frameworks for registered securities exchanges and ATSS are intended to address these risks.<sup>3</sup>

Unfortunately, in the equities markets, the rise in off-exchange ATSS trading seemed to also give rise to a disproportionate number of abuses and market distortions. For example, a slew of settlements with regulators found ATSS operators engaged in or enabled:

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<sup>1</sup> *Amendments Regarding the Definition of “Exchange” and Alternative Trading Systems (ATSS) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities*, SEC, 87 Fed. Reg. 15496 (Mar. 18, 2022), available at <https://www.govinfo.gov/content/pkg/FR-2022-03-18/pdf/2022-01975.pdf> (“Proposal”).

<sup>2</sup> Healthy Markets Association (“HMA”) is a not-for-profit member organization of public pension funds, investment advisers, broker-dealers, exchanges, and market data firms focused on reducing conflicts of interest and improving the transparency, efficiency, and fairness of the capital markets. HMA members are directly impacted by this Proposal. The positions asserted herein are those of HMA only, and do not necessarily reflect the opinions or positions of any particular member or subscriber. To learn more about HMA or our members, please see our website at <http://healthymarkets.org/about>.

<sup>3</sup> We have separately identified several areas where the Commission’s current oversight of exchanges is inadequate, and should be improved, including the process for reviewing and approving exchanges’ rules. See, e.g., Letter from Tyler Gellasch, HMA, to Hon. Gary Gensler, SEC, Oct. 29, 2021, available at <https://www.sec.gov/comments/sr-cboeedga-2021-017/srcboeedga2021017-9360012-261666.pdf>.

- trading ahead of or against subscribers' orders;
- selectively sending indications of interest ("IOIs") to algorithmic trading firms, which allowed those firms to execute against subscribers in the pool, but also enabled those firms to trade away—and ahead—of the ATS's subscribers;
- sending subscribers' orders to other market centers without telling those subscribers;
- allowing the ATS operator's smart order router ("SOR") to use subscribers' order information when making unrelated order routing decisions;
- failing to police their ATS as advertised, including by rating their own trading desk and HFT firms as less predatory than the objective criteria would indicate;
- providing misleading information about the trading characteristics of the ATSI and its major participants;
- allowing employees or third-parties who had no role in ATS operations or oversight to have access to customers' confidential trading information;
- failing to construct the National Best Bid and Offer ("NBBO") as advertised;
- failing to monitor and restrict trading by subscribers in violation of the Market Access Rule; and
- violating the fair access requirements.<sup>4</sup>

Notably, for ATSS that trade five percent (5%) of a single stock or one-quarter percent (.25%) of all NMS stocks by average daily dollar volume for four or more months out of a rolling six-month window are required to comply with Regulation Systems Compliance and Integrity.<sup>5</sup> Reg SCI, which also applies to all registered securities exchanges, is intended to ensure that critical market infrastructure is robust, resilient, and operates with integrity. Specifically, Reg SCI mandates that covered entities:

- establish written policies and procedures reasonably designed to ensure that their systems have levels of capacity, integrity, resiliency, availability, and security adequate to maintain their operational capability and promote the maintenance of fair and orderly markets, and that they operate in a manner that complies with the Exchange Act;

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<sup>4</sup> Letter from Dave Lauer, HMA, to Brent J. Fields, SEC, at 2, Feb. 26, 2016, *available at* <https://healthymarkets.wpengine.com/wp-content/uploads/2018/04/02-26-16-HM-letter-Regulation-of-NM-S-Stock-ATSS.pdf> (noting that "[t]he purposes underlying the Proposal apply nearly equally with respect to ATSS trading other assets.") ("HMA ATS Letter I").

<sup>5</sup> *Regulation Systems Compliance and Integrity*, SEC, 79 Fed. Reg. 72252 (Dec. 5, 2014), *available at* <https://www.govinfo.gov/content/pkg/FR-2014-12-05/pdf/2014-27767.pdf> ("Reg SCI")

- mandate participation by designated members or participants in scheduled testing of the operation of their business continuity and disaster recovery plans, including backup systems, and to coordinate such testing on an industry- or sector-wide basis with other SCI entities;
- take corrective action with respect to SCI events (defined to include systems disruptions, systems compliance issues, and systems intrusions), and notify the Commission of such events;
- to disseminate information about certain SCI events to affected members or participants and, for certain major SCI events, to all members or participants of the SCI entity;
- to conduct a review of their systems by objective, qualified personnel at least annually, submit quarterly reports regarding completed, ongoing, and planned material changes to their SCI systems to the Commission, and maintain certain books and records.<sup>6</sup>

While NMS Stock ATs generally try to avoid triggering those thresholds (so as to avoid having to comply with Reg SCI), these efforts have not always worked.<sup>7</sup>

In 2015, the Commission proposed addressing some of these failures in ATs that trade National Market System (NMS) Stocks through reforms to Regulation ATS, including with the creation of a new Form ATS-N.<sup>8</sup> At that time, HMA urged the Commission to enhance conduct rules and disclosures for ATs beyond those that trade NMS stocks.<sup>9</sup> Nevertheless, when the Commission adopted ATS reforms in 2018, it narrowly tailored those reforms to apply to NMS Stock ATs.<sup>10</sup>

Finally, in September 2020, the Commission proposed adopting significant reforms to ATs that trade government securities,<sup>11</sup> and we offered our support.<sup>12</sup> The current Proposal would revise the recent past Commission proposal, as well as revise the definition of an “exchange” to include a number of activities that are not currently interpreted as giving rise to exchange regulation.

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<sup>6</sup> Reg SCI, at 72252.

<sup>7</sup> See, *In the Matter of Virtu Americas, LLC*, SEC, Admin. Proc. File. No. 3-19563, Sept. 30, 2019, available at <https://www.sec.gov/litigation/admin/2019/34-87155.pdf>.

<sup>8</sup> *Regulation of NMS Stock Alternative Trading Systems*, SEC, 80 Fed. Reg. 80998 (Dec. 28, 2015), available at <https://www.govinfo.gov/content/pkg/FR-2015-12-28/pdf/2015-29890.pdf>.

<sup>9</sup> HMA ATS Letter I, at 5.

<sup>10</sup> *Regulation of NMS Stock Alternative Trading Systems*, SEC, 83 Fed. Reg. 38768 (Aug. 7, 2018), available at <https://www.govinfo.gov/content/pkg/FR-2018-08-07/pdf/2018-15896.pdf>.

<sup>11</sup> *Regulation ATS for ATs That Trade U.S. Government Securities, NMS Stock, and Other Securities; Regulation SCI for ATs That Trade U.S. Treasury Securities and Agency Securities; and Electronic Corporate Bond and Municipal Securities Markets*, SEC, 85 Fed. Reg. 87106 (Dec. 31, 2020), available at <https://www.govinfo.gov/content/pkg/FR-2020-12-31/pdf/2020-21781.pdf>.

<sup>12</sup> Letter from Tyler Gellasch, HMA, to Vanessa Countryman, SEC, Mar. 22, 2021, available at <https://www.sec.gov/comments/s7-12-20/s71220-8530174-230263.pdf> (“HMA Letter II”).



## Regulation of Government ATSS

Electronic trading venues for fixed income securities – not just government securities – should be registered with the Commission as exchanges or ATSS. Further, electronic communications systems that help buyers and sellers identify liquidity, but do not match firm trades (such as through a central limit order book) should be regulated as broker-dealers, registered with FINRA, and subject to oversight. This would ensure important investor and market protection measures including business continuity plans and written supervisory procedures are applied uniformly.

Further, we believe that trading venues that “look and operate like an exchange or otherwise perform a “matching” function should be regulated like an exchange or ATS.”<sup>13</sup> We agree with the Commission’s assessment that

Legacy Government Securities ATSS now operate with complexity similar to that of markets that trade NMS stocks in terms of use of technology and speed of trading, the use of limit order books, order types, algorithms, connectivity, data feeds, and the active participation of principal trading firms.<sup>14</sup>

At the same time, not all ATSS for government securities are currently registered. In fact, most are not. That’s because the regulation of ATSS that trade government securities is significantly different from the regulation of ATSS that trade stocks. As the Proposal explains,

an ATS that limits its securities activities to government securities or reverse repurchase agreements on government securities (“repos”) and registers as a broker-dealer or is a bank (i.e., a Currently Exempted Government Securities ATS) is exempt from exchange registration and is not required to comply with Regulation ATS. Further, ATSS that trade both government securities and non-government securities (e.g., corporate bonds) are subject to Regulation ATS but are not required to comply with many of its investor protection and fair and orderly markets provisions, including public transparency rules and the obligation to provide fair access to investors if the ATS has significant trading volume. In addition, ATSS that trade government securities are not subject to the systems integrity provisions of Regulation SCI.<sup>15</sup>

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<sup>13</sup> HMA Letter II, at 5-6.

<sup>14</sup> Proposal, at 15513.

<sup>15</sup> Proposal, at 15497.



All of those considerations should change.

We are particularly focused on the importance of the application of Regulation SCI. In 2019, the largest electronic venue for trading on-the-run US Treasury Securities, the CME Group's BrokerTec, suffered an outage.<sup>16</sup> And while catastrophe was avoided, this event highlighted how "it is important to impose the requirements of Regulation SCI to help ensure that the technology systems of such Government Securities ATs are reliable and resilient."<sup>17</sup>

To be most useful, the new filings required by revisions to Government Securities ATs should be clear and easily found by investors and the public. We agreed with the 2020 Proposal to have Government Securities ATs file a new form ATS-G. Requiring Government Securities ATs to file a Form ATS-N would pose challenges for firms seeking to file the forms, but could also lead to confusion, such as if a firm offers trading for different asset classes in different ATs. Instead, we suggest the Commission simply include on form ATS-G all information that may be applicable to that asset class. While this form should be very similar in content to an ATS-N, substantively, it will be different.

We recommend that the Commission identify on its website, as it does with registered securities exchanges, an easy-to-access location for all filings by each registered ATS, including Government Securities ATs.<sup>18</sup>

The Proposal would eliminate confidential treatment for information about the type(s) of securities that the ATS trades. This information could provide investors and other users of ATs with important information regarding their potential counterparties and risks posed by trading in particular venues. Given that many ATs already provide this information, we see no reason why this would be difficult to implement.

Lastly, knowing who are likely to be other participants interacting on a trading venue is often a key consideration for investors and others seeking to assess the risks and opportunities posed by engaging with an ATS. Unfortunately, we have seen past instances where trading venues have misled market participants about the number and nature of firms that trade on those venues.

Historically, many ATs have shared customer-related information with market participants, such as customer types and percentages of overall trading volumes attributable to each type. While ATs could be required to publicly disclose customer lists on a quarterly or annual basis, we recognize that this could potentially disincentivize firms from trading on smaller venues, potentially inhibiting competition. Another way to address this need for investors and other market participants would be

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<sup>16</sup> Elizabeth Stanton, Nick Baker, and Matthew Leising, *Treasuries Hit by One-Hour Outage on Biggest Electronic Platform*, Bloomberg, Jan. 11, 2019, available at <https://www.bloomberg.com/news/articles/2019-01-11/brokertec-inter-dealer-treasury-broker-suffers-outage>; see also, Proposal, at 15601, n.835.

<sup>17</sup> Proposal, at 15526.

<sup>18</sup> HMA Letter II, at



to require ATSS to publicly disclose on a quarterly basis the segmentation of customer types on the trading venue, along with percentages of overall trading by each of those customer types.<sup>19</sup>

## Definition of an Exchange

We appreciate the Proposal's broadly scoping the definition of an "exchange" to cover all securities, including "government securities, corporate bonds, municipal securities, NMS stocks, equity securities that are not NMS stocks, private restricted securities, repurchase agreements and reverse repurchase agreements, foreign sovereign debt, and options."<sup>20</sup> Venues that are offering trading in unregistered securities, for example, should be subject to the governance and investor protection provisions of the Exchange Act.<sup>21</sup>

Trading venues, including exchanges and ATSS, should be subject to integrity, capacity, and security standards that accompany exchange registration and Regulation ATS, respectively. If a trading venue ceases trading, the markets can be materially disrupted.

We agree with the Commission's assessment that market participants frequently use systems that "offer the use of non-firm trading interest and establish protocols to prompt and guide buyers and sellers to communicate, negotiate, and agree to the terms of the trade without relying solely on the use of orders."<sup>22</sup>

Electronic communications systems are increasingly used by market participants to find liquidity for trading in securities. However, communications systems – by themselves – are not exchanges. The Proposal would require "Communication Protocol Systems" to register as exchanges, or register as ATSS. We agree that Communication Protocol Systems should be subject to FINRA registration as brokers, and subject to oversight as such (including subject to disclosures and record-keeping requirements). Put simply, the Commission should consider proposing a rule that provides a clear definition for "Communication Protocol System" and requires broker-dealer registration and specific disclosure and record-keeping requirements.

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<sup>19</sup> Notably, this information should not be tied to any specific public trade-related information. There is a divergence of opinions amongst HMA members regarding the relative costs and benefits associated with mandatory public disclosures of ATS client lists or types.

<sup>20</sup> Proposal, at 15498.

<sup>21</sup> We note that some commenters in the digital asset community have objected to the proposal on grounds of its purported impact on trading in digital assets. Of course, the proposal would apply to trading in securities only. As a result, the reforms could and should apply to only those digital assets that meet the definition of a security. That is not just appropriate, but essential, for the Commission to avoid unnecessarily creating regulatory inconsistencies and loopholes, and fulfill its investor protection mandate.

<sup>22</sup> Proposal, at 15500.



## Conclusion

We urge the Commission to revise the Proposal and adopt it without delay. Thank you for your consideration. Please feel free to contact me by email at [REDACTED] or telephone at [REDACTED] for any follow up.

Sincerely,

Tyler Gellasch  
Executive Director