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Via E-Mail: rule-comments@sec.gov

Brent J. Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Transaction Fee Pilot for NMS Stocks (File No. S7-05-18)

Dear Mr. Fields:

I am an assistant professor of finance at the University of Illinois at Urbana-Champaign, and my main area of research is market microstructure. I appreciate the opportunity to provide comments to the U.S. Securities and Exchange Commission (the "Commission") on its proposal for a pilot program to experimentally investigate transaction fees. At the highest level, I strongly support a transaction-fee pilot. It will generate the much-needed data required to rigorously analyze a major feature of modern U.S. equities markets. However, the details of implementation are important, and I comment below on several issues.

Timing

I encourage the Commission to proceed quickly in launching the Transaction Fee Pilot. In particular, I support the plan to proceed with a pilot in the near term, rather than postponing the pilot until after the Commission issues additional guidance on broker-dealers' duty of best execution and takes final action on the proposed rules regarding order-handling disclosure and ATS regulation. I agree with the Commission that the data generated by the pilot would serve to inform and improve rule-making and regulatory action going forward. While I do not necessarily share IEX's view that the recommendations to postpone are intentional "delaying tactics motivated by 'commercial protectionism'," I see no research benefit from such postponement.

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The potential overlap between the Tick Size Pilot and the proposed Transaction Fee Pilot initially worried me, but the Commission's plan for how to proceed in the event of overlap allayed my concerns. I have thought through how I would go about analyzing data from the Transaction Fee Pilot in each case (the overlap case and the no-overlap case, respectively), and my conclusion is that overlap would be a minor inconvenience, but it certainly would not be a serious impediment. All else being equal, the "no-overlap" scenario would be slightly cleaner and would offer slightly greater statistical power, but these small advantages are not sufficient to justify any significant delay of the Transaction Fee Pilot.

Design—Experimental Treatments

Of the proposed experimental treatment groups, Group 3 (prohibition on rebates and Linked Pricing) is by far the most important. While Group 1 and Group 2 (tightened fee caps) will likely produce some useful auxiliary data, Group 3 will deliver the most compelling and economically interpretable evidence. I furthermore concur with the Commission's position that the prohibition *should* also apply to depth-of-book and undisplayed liquidity, given the scope for distortionary circumventions of the prohibition to arise otherwise.

Although the proposed fee-caps of $0.0015 and $0.0005 seem reasonable, they are also somewhat *ad hoc.* Viewed in terms of percentage-of-price, the caps will inevitably be rather inexact; a fee-cap of $0.0015 will affect a stock priced at $14 per share in a different manner than it will a stock priced at $322 per share.[i] For this reason, I believe that the Commission need not devote great energy to fine-tuning the specific fee-caps for Group 1 and Group 2. Similarly, this reasoning highlights the special importance of the complete prohibition on rebates and Linked Pricing in Group 3—a rebate of $0 always translates exactly to a rebate of 0%. Along the same lines, I also suggest that the Commission consider adopting a "no-cap" condition for a Test Group, i.e., exempting that group from the Rule 610(c) $0.003 access-fee cap. This would be a valuable experimental treatment because it would generate data that reflect unconstrained equilibrium outcomes. A picture of the unconstrained outcome would be much more useful for economic analysis than would an additional picture of some further-constrained equilibrium.

Concerns

One element of the pilot proposal document (34-82873) that particularly worries me pertains to allowing exchanges to adopt new rules providing non-rebate Linked Pricing to their respective "registered market makers" (see pages 59-60). I commend the Commission for recognizing the importance of permitting such incentive schemes, and I very much support the basic idea, but this portion of the proposal requires additional clarification and detail.

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Recent research has provided strong evidence that NYSE Designated Market Makers ("DMMs") have a unique beneficial effect on market quality, caused by their distinctive contractual obligations.[ii] Market makers on other exchanges do not face analogous obligations, and while those market makers may nonetheless improve liquidity, they are still qualitatively different from NYSE DMMs. NASDAQ market makers, for example, more closely resemble the NYSE Supplemental Liquidity Providers ("SLPs"). Will new rules providing non-rebate Linked Pricing be permitted to apply to market participants such as the SLPs? Are the NYSE DMMs' current performance obligations deemed sufficient consideration for current Linked-Pricing schemes? More generally, when some exchange proposes a rule change, what criteria will be used to judge whether the market-making obligations are commensurate with the (non-rebate) Linked-Pricing incentives? I urge the Commission to address and clarify matters such as these.

My comments here are by no means comprehensive, but I hope that they will—to at least some small extent—help the Commission in this important endeavor. Please feel free to contact me with any questions, or for further discussion.

Sincerely,

Adam D. Clark-Joseph

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[i] This essentially follows as a direct corollary of established results for relative tick size. See, for example:
O'Hara, Maureen, and Gideon Saar, and Zhuo Zhong. *Relative Tick Size and the Trading Environment* (2015). http://dx.doi.org/10.2139/ssrn.2463360

[ii] See, for example, the following two studies:
Clark-Joseph, Adam D., and Mao Ye, and Chao Zi. *Designated market makers still matter: Evidence from two natural experiments* (2017). Journal of Financial Economics, Volume 126, Issue 3, Pages 652-667. https://doi.org/10.1016/j.jfineco.2017.09.001.
Bessembinder, Hendrik, and Jia Hao, and Kuncheng Zheng. *Liquidity Provision Contracts and Market Quality: Evidence from the New York Stock Exchange* (2017). Northeastern U. D'Amore-McKim School of Business Research Paper No. 2899147.

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