



May 15, 2018

Via Electronic Submission:

Mr. 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

Dear Mr. Fields:

Managed Funds Association¹ (“**MFA**”) is pleased to have the opportunity to submit comments to the Securities and Exchange Commission (“**SEC**” or “**Commission**”) on its proposed Transaction Fee Pilot for NMS Stocks (“**Pilot**”).² As the Commission noted:

The purpose of the Pilot is to study the effects that transaction-based fees and rebates may have on, and the effects that changes to those fees and rebates may have on, order routing behavior, execution quality, and market quality more generally.³

In formulating the proposed Pilot, the Commission has clearly benefited from its diligent work gathering input from a wide range of market participants and has learned valuable lessons from past pilots. We especially commend the Commission for issuing the Pilot as a rule proposal for public comment, rather than as a national market system plan pursuant to Rule 608(a)(3) of Regulation NMS under the Securities Exchange Act of 1934, since it ensures the Pilot is commercially disinterested while subject to a fulsome economic analysis. MFA generally supports the Pilot as proposed and urges the Commission to resist the temptation to add further complexity to the plan, such as adding a trade-at provision or running the Pilot concurrently with the Tick Size Pilot.

¹ Managed Funds Association (“MFA”) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

² Transaction Fee Pilot for NMS Stocks, 83 Fed. Reg. 13008 (Mar. 26, 2018) (hereinafter, “**Pilot**”), available at: <https://www.gpo.gov/fdsys/pkg/FR-2018-03-26/pdf/2018-05545.pdf>. See *infra* n. 7 for a description of the Pilot Test Groups.

³ *Id.*

I. Introduction

MFA and its members believe that the U.S. equity market structure works reasonably well for investors and to raise capital for businesses. The U.S. equity markets have evolved dramatically over the last thirty years with both regulatory changes and technological innovations that have largely benefited retail and institutional investors. We support that regulators should periodically assess market practices and regulations to ensure that U.S. equity markets continue to remain efficient, liquid, fair, resilient and transparent for all market participants. In doing so, we support the Commission's approach to assess market practices through a pilot program and to make data-driven determinations.

As the Commission evaluates the Pilot, public comments, and equity market structure reform, MFA urges it to adhere to the following principles:⁴

- For the SEC to “remain focused on the long-term interest of our Main Street investors”, who invest directly in stocks as well as through exchange-traded funds, mutual funds and pension plans.⁵
- Changes to market structure should be made deliberately and only after a disciplined, data-driven study to ensure that rulemaking is driven, less by competitive interests among market intermediaries and trading venues, and more by measurable benefits to investors and issuers in terms of liquidity, efficiency, competition and capital formation.
- Equity market structure reform should balance the goal of reducing unnecessary market complexity and costs, with the benefits of fostering competition in the investors' favor.

II. Comments

a. Scope and Design of Pilot

MFA agrees that the scope of the Pilot should be to test the impact of transaction fees and rebates on order routing behavior, execution quality, and market quality, instead of all aspects of equities market structure, including market fragmentation and the proliferation of complex order types.⁶ We support a Pilot designed in as simple and straight-forward a manner as possible. That approach will help reduce implementation costs for market participants and simplify review of the data collected. If the Pilot is designed with too many variables, it will be costly for market participants to implement and difficult afterwards for the Commission and researchers to draw sound inferences for future rulemaking.

The Pilot should remain largely as proposed; specifically, it should be limited to equity exchanges, cover securities of all market capitalizations, exclude non-exchange trading centers, and exclude a trade-at

⁴ See, e.g., letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Mary Jo White, Chair, SEC, on September 28, 2015, on MFA equity market structure policy recommendations, available at: <https://www.managedfunds.org/wp-content/uploads/2015/09/Equity-Market-Structure-Recommendations-with-Cover-Letter.pdf>.

⁵ Jay Clayton, Chairman, SEC, Remarks at the Equity Market Structure Symposium Sponsored by the University of Chicago and the STA Foundation, April 10, 2018, available at <https://www.sec.gov/news/speech/speech-clayton-2018-04-10>.

⁶ See Pilot *supra* n. 2 at 13,014.

component. With respect to the selection of Pilot securities, the current number of securities in each Test Group as proposed is certainly sufficient to derive statistically robust results, but the Commission should consider additional mechanisms to ensure that each group includes representative samples of securities with varying liquidity profiles and market capitalization.

It is particularly important that the Pilot continue to exclude a trade-at component. MFA concurs with the Commission's determination that the Pilot does not raise the same concerns of increased off-exchange trading as were present in the Tick Size Pilot, and therefore a trade-at component would needlessly make the Pilot more costly and complex.⁷ Many firms including some MFA members have refrained from trading securities subject to the trade-at provision of the Tick Size Pilot, and would therefore have to implement from scratch a trade-at component if it were included in the Pilot. A trade-at component would also add a new test group to the Pilot, thereby making it more difficult and time consuming for institutional investors to review their trading strategies in accordance with their best execution obligations. Imposing a trade-at component on the type of securities contemplated for the Pilot would be a radical change that is simply not justified by the goals of the Pilot.

We also believe that the Pilot should not overlap with the Tick Size Pilot. Studies suggest that the Tick Size Pilot has had a detrimental impact for investors and we therefore respectfully urge the Commission to let the Tick Size Pilot expire as scheduled on October 3, 2018.⁸ Letting the Tick Size Pilot terminate is unlikely to materially delay the implementation of the Pilot, but the flip side is almost certain to introduce complexity to the Pilot. Having overlapping pilot programs, even if only for a few months, would add competing causation factors that could skew the Commission's analysis of order routing behavior, execution quality, and market quality.

b. Access Fee

MFA supports a Pilot with three Test Groups with different access fee/pricing restrictions and one control group.⁹ While we look forward to analyzing the Pilot's data, MFA members preliminarily believe that the current \$0.0030 access fee cap is too high and has become outdated since the SEC's adoption of Regulation NMS in 2005.¹⁰ In the 13 intervening years, the market has evolved and many buy-side participants now play a greater role in providing liquidity as they execute their strategies regardless of rebates. As such, we support testing the impact of lower fee caps and of prohibiting rebates generally, and believe that the Commission should consider permanently lowering the access fee under Rule 610(c).¹¹

⁷ See Pilot *supra* n. 2 at 13,070.

⁸ See, e.g., Colleen Ruane & Phil Pearson, ITG, *Tick Pilot Update*, Jan. 2017, available at https://www.itg.com/assets/ITG_TL_RuanePearson_20170130.pdf (noting that trading costs among more than 100 institutional investors are almost 50% higher in Tick Pilot Securities, compared with the control group); Peter Reinhard Hansen et al., *Mind the Gap: An Early Empirical Analysis of SEC's Tick Size Pilot Program*, May 22, 2017, available at http://faculty.chicagobooth.edu/workshops/econometrics/PDF%202017/Hansen_TickSizePilot.pdf (noting that the wider tick size has increased stock return volatility by 16% and reduced average trade volume by about 6%).

⁹ Test Group 1 provides for a \$0.0015 fee cap without a cap on rebates; Test Group 2 provides for a \$0.0005 fee cap without a cap on rebates; and Test Group 3 prohibits rebates and linked pricing with respect to removing and providing displayed and undisplayed liquidity. See Pilot *supra* n. 2 at 13,015.

¹⁰ See Regulation NMS Adopting Release, 70 Fed. Reg. 37496 (June 29, 2005), available at: <https://www.sec.gov/rules/final/34-51808fr.pdf>.

¹¹ 17 CFR § 242.610(c).

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MFA appreciates the opportunity to provide its views on the Pilot. We would welcome the opportunity to discuss our comments with the Commission or its staff. Please feel free to contact Jennifer Han, Associate General Counsel, MFA, or the undersigned at [REDACTED].

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

CC: The Honorable Jay Clayton, Chairman
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner
The Honorable Robert J. Jackson Jr., Commissioner
The Honorable Hester M. Peirce, Commissioner
Mr. Brett Redfearn, Director, Division of Trading and Markets
Mr. David Shillman, Associate Director, Division of Trading and Markets