



May 23, 2018

Via Electronic Mail (rule-comments@sec.gov)

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

Re: Proposed Transaction Fee Pilot for NMS Stocks
File Number S7-05-18

Dear Mr. Fields:

Virtu Financial Inc. (together with its affiliates, “Virtu” or “we”)¹ appreciates the opportunity to comment on the Securities and Exchange Commission’s (“SEC” or the “Commission”) Proposed Rule for a Transaction Fee Pilot for NMS Stocks (“Pilot”). We commend the Commission’s efforts to undertake a data driven approach in the review of transaction fees and rebates.

However, we are concerned with the premise that market structure changes are the answer to the issue of perceived routing conflicts attendant to the current transaction fee/rebate structure. In our view, another industry pilot is not the way to address these perceived conflicts.² Instead, we submit that the Commission propose updates and modifications to SEC Rules 605 and 606

¹ Virtu is a leading technology-enabled market maker and liquidity provider to the global financial markets. Virtu operates as a market maker across numerous exchanges in the U.S. and is a member of all U.S. registered stock exchanges. Virtu provides liquidity in more than 25,000 instruments on more than 235 venues and marketplaces and seeks to provide liquidity on instruments traded on transparent electronic markets globally. As such, it broadly supports innovation and enhancements to transparency and fairness which enhance liquidity to the benefit of all marketplace participants.

² As Brett Redfearn, Director, Division of Trading and Markets, recently noted in an industry seminar, there are 17 Commission sponsored pilots currently pending, some of which have been running for several years. The U.S equity markets should not be continually used as a testing site to experiment on theories of some market participants. The disruptive effects and risks of unintended consequences (for example, causing a negative impact to an issuer by inclusion in one fee bucket instead of another which may include a competitor issuer) is far too great and could result in significant harm to the markets, issuers and investors.



requiring enhanced disclosures including *inter alia* transaction fees paid, rebates received, and execution costs.

If the Commission decides to proceed with the Pilot, we recommend that it be narrowly tailored to create the least amount of disruption to the market and we offer the following additional comments including:

- The Pilot should not include a Trade-At component;
- ATSS should be excluded from the Pilot;
- ETPs should be excluded from the Pilot; and
- The Pilot's confidentiality protections must be enhanced.

I. Introduction

The U.S equity markets are the most efficient and fair markets in the world, involving numerous constituents and competing interests that act in unison. All metrics of market quality clearly demonstrate that investors are benefiting from better markets today than at any prior period in history. As has been widely reported, technological advancements and Commission rulemaking (such as Regulation NMS) have been successful in increasing market-enhancing competition between, other exchanges, broker-dealers and alternative execution venues, which has improved execution quality and dramatically lowered execution costs.

Over the last 10 years, the markets have become more efficient and effective: bid-ask spreads are narrower than ever before, and executions are fast, automated and reliable. The ability for all investors, institutional and individual, to participate in the capital markets and instantaneously access liquidity has never been easier or as inexpensive. Further, execution quality and transparency for both large and small orders is better than ever. Current equity market structure promotes robust competition and technological innovation among a diverse set of market participants which, most significantly, enables investor choice.

II. Exchange Rebates Provide Tangible Benefits to the Equity Markets

Notwithstanding the fact that there have been significant improvements and productive developments in the equity markets over the last 10-15 years, there is a view among some market participants that exchange rebates are either unfair or create irreconcilable conflicts in order routing behavior. We do not hold that opinion.



Exchange rebates enhance liquidity by incentivizing broker-dealers to publicly display quotes and compete with one another in a manner that narrows the bid-ask spread to the ultimate benefit of all market participants. As a result, rebates have a beneficial effect on the price discovery and formation function that publicly displayed quotations provide. A broad array of market participants with differing time horizons, investment goals and outcomes benefit from the liquidity and price discovery that is the by-product (in part) of rebates.

Rebates can be used by broker-dealers to help fund price improvement and payment for order flow programs for retail investors.³ As such, rebates indirectly provide benefits to retail investors in the form of better execution prices and lower commission rates, both of which help reduce overall trading costs. Additionally, brokers-dealers like Virtu may enter into client commission arrangements where the client pays access fees and receives the rebates accrued as a result of their executions. Clients in these arrangements directly benefit from the rebates.

III. The Conflict Concerns Sought to be Examined by the Pilot Should Instead be Addressed Through Enhanced Rule 606 Disclosures

Instead of tinkering further with the workings of free and orderly markets, Virtu has consistently stated that the proper manner to address any perceived conflict is through enhanced disclosure and transparency. As expressed by former Commissioner Troy Paredes:

Disclosure is the cornerstone of the federal securities laws.... The essence of the disclosure philosophy of securities regulation is that investors, when armed with information, are well-positioned to evaluate their investment opportunities and to allocate their capital as they see fit. When investors are able to make informed decisions, it is more likely that the capital that fuels our economy will finance more productive enterprises than if investors did not have the benefit of useful information when deciding how to invest.⁴

It is in this context that Virtu strongly supports the reexamination and modernization of Rules 605 and 606⁵ and the expansion of the rules to require the disclosure of transaction fees paid

³ In 2017, Virtu paid over \$300 million in price improvement to retail investor orders.

⁴ Commissioner Troy A. Paredes, Remarks at The SEC Speaks in 2013, February 22, 2013, <https://www.sec.gov/news/speech/2013-spch022213taphtm>.

⁵ The Commission is presently studying ways in which to improve upon Rule 606. See, Release No. 34-78309, File No. S7-14-16, Disclosure of Order Handling Information, www.sec.gov/rules/proposed/2016/34-78309.pdf. As a



and rebates received in a manner tailored to address the concerns of investors. Any claim that the receipt of a rebate may distort price discovery would be wholly eliminated if the amount of rebate received was required to be disclosed. Taking this position one step further, we would support a disclosure regime that would require the disclosure of all execution fees, such as connectivity and port fees and market data costs. This approach gets to the very heart of what the SEC is seeking to address and allows investors to better understand the relationships of routing brokers and execution venues and to assess the potential conflicts of interest for themselves. Equally as important, this path avoids altering market structure in a manner that favors one business model over another through regulatory fiat. As history has unequivocally shown, disclosure and transparency are far better at fostering competitive and healthy markets than restricting the free forces of supply and demand via government intervention.

Virtu is committed to providing our clients with information (including information about fees paid to and rebates received from market centers) and analytics that they need to assess execution quality. We have consistently “practiced what we preach” by providing our clients and the public with greater levels of order handling information than otherwise required under existing regulations. For example, Virtu Americas LLC (“Virtu Americas”) discloses as part of its quarterly Rule 606 statistics the aggregate fees paid to and rebates received from each execution venue. To the best of our knowledge, we are one of the only firms that provides this level of detail in its Rule 606 disclosures. Further, Virtu Americas, in conjunction with the Financial Information Forum and other retail broker-dealers and wholesalers, worked to develop a voluntary protocol to supply additional execution statistics to the retail community that are intended to provide an enhanced perspective on execution quality beyond the current Rule 605 framework. Virtu and other firms are voluntarily publishing these metrics in addition to the information required under Rule 605.

To reiterate, any perceived conflicts associated with a broker-dealer’s receipt of an exchange rebate can be squarely addressed and remedied with a disclosure framework showing specific details concerning the nature and amount of the rebates received/transaction fees paid. Investors can use this data to make order routing decisions and provide additional instructions to their broker-dealer. We believe that proposing changes to SEC Rules 605 and 606 and soliciting feedback with a view towards modernizing these disclosures is a superior, more direct and more cost-effective approach over another pilot conducted in a live market setting that may or may not achieve the benefits that disclosure certainly will provide. Through such a proposal market, participants will have the opportunity to voice their opinions on the nature of such disclosures, the

general matter, Virtu is supportive of the proposal’s efforts to revamp order handling disclosure requirements to meet the differing needs of retail and institutional investors.



timing or such disclosures, and the level of granularity that would be most helpful in evaluating the routing practices of their brokers. Brokers will be held to a standard that provides uniformity and they may also compete to provide voluntary enhanced disclosures their clients find useful.

IV. Specific Pilot Comments and Recommendations

A. A “Trade-At” component should be specifically excluded from the Pilot.⁶

Virtu is concerned that the inclusion of a “Trade-At” requirement in the Pilot will only add unnecessary complexity without providing any additional benefits. Virtu is not the only market participant that shares this view. The Equity Market Structure Advisory Committee⁷ has also urged that the Pilot exclude a Trade-At component.

The concerns that have been traditionally proffered in support of a Trade-At requirement revolve around insuring that off-exchange trading does not have a deleterious effect on the price discovery and formation function that publicly displayed quotations provide.⁸ We recognize that publically available quotes serve an important function and the Commission rightfully should study aspects of the market that impact published quotations. We also recognize the Commission’s desire and need to have data to inform their views regarding the benefits and consequences of potential market structure changes. Trade-At requirements were already included as a component of the Tick-Size Pilot and, as such, the Commission is already receiving data that can be studied and evaluated.⁹

The proposed Pilot’s core objective is to gauge the impact of transaction fees and rebates on broker’s routing behaviors. A Trade-At component in the Pilot, which restricts broker-dealers’ routing decisions, will not further that core objective and contribute data that will assist the Commission to evaluate how differences in fees and rebates may affect a broker’s routing choices. Rather, providers of off-exchange liquidity will be forced to route orders to venues for reasons wholly unrelated to the venue’s fee or rebate structures. This change will limit competition

⁶ See, Pilot at page 64, question 29.

⁷ Securities and Exchange Commission Equity Market Structure Advisory Committee, Recommendation for an Access Fee Pilot, July 8, 2016.

⁸ We suggest that some of the proponents of a trade-at requirements are pushing for this change for competitive reasons rather than altruistic concerns about the price discovery formation function that public quotes help to provide.

⁹ We believe that once the Commission studies the Tick Pilot data it will conclude that Trade-At requirements do not ultimately protect the price discovery and formation mechanism of public quotes.



between market participants and put the Commission in the position of picking “winners” and “losers” in order routing. This should not be the function of regulation.

Accordingly, we submit that the inclusion of a Trade-At requirement would unnecessarily alter the very data the Commission seeks to obtain and unnecessarily complicate an already complex study addressing a long-standing market debate. In addition, including a Trade-At requirement will add additional burdens on broker-dealers, which will have to make complex programming changes to their systems to accommodate the Pilot for no meaningful gain in relevant data.

B. The Pilot should include all equity exchanges but should exclude ATSS.¹⁰

Virtu recommends that ATSS be excluded from the Pilot. The exchanges already enjoy a competitive advantage provided by the SEC Rule 611, the Trade Through Rule. This advantage was the precise reason why fee caps were imposed under SEC Rule 610. Because ATSS are now structured such that they do not provide public quotes, they do not enjoy the same advantages that have been bestowed on the exchanges. ATSS also do not enjoy other benefits that exchanges derive in the form of revenue from participation in market data plans and other fees.

Because ATSS do not receive the benefits of the order protection rule, the cost for accessing liquidity on ATSS is currently not subject to any fee caps. Notwithstanding their ability to charge fees that are greater than the caps imposed on exchanges, ATSS generally charge far less. Because they are not protected market centers, ATSS must compete for business by providing competitive access rates, rebates and innovative structures. The Pilot, as currently proposed, will already allow the Commission to obtain data on how lower exchange fees might alter brokers’ routing behaviors, including whether order flow would migrate back to the exchanges. Including ATSS in the Pilot would have the unintended and harmful effect of unnecessarily changing ATSS business models, potentially hurting their competitiveness, and would alter the data that the Commission is collecting in a manner that would not provide an effective “apples to apples” analysis.

¹⁰ See, Pilot at page 35, question 3.



C. The Pilot should exclude ETPs to avoid potential liquidity side effects.¹¹

Virtu submits that ETPs, which are part of exchange programs like the New York Stock Exchange Lead Market Maker Program, the BATS LMM program and the NASDAQ Designated Liquidity Provider Program that incentivize market makers to quote in an entire family of ETPs, be excluded from the Pilot. By participating in these programs and incurring enhanced quotation obligations, Virtu receives economic trading incentives from quoting both actively traded ETP products and less actively traded products. We choose to review these incentives holistically and, as a result, we also choose to provide liquidity broadly across the full spectrum of ETPs. As such, the ETP ecosystem has a completely different market structure in this context. Incentives are paid directly to market makers by the exchanges to support a market maker's efforts to make markets for the ultimate benefit of investors. If these incentives are eliminated or reduced, Virtu, and others similarly situated, may be placed in the untenable position of ceasing to make a market in less liquid ETP names.

Based on a recent review of ETP data from Bloomberg, 477 ETPs trade less than 2,000 shares a day and another 234 products trade between 5,000 and 2,000 shares a day; we believe both groups will be negatively impacted if rebates are eliminated or reduced. Collectively, these 711 ETPs hold over \$32 billion of investor assets. As such, the Pilot will likely harm investors in these less liquid ETPs, which will be faced with less liquidity and wider spreads when they seek to sell their holdings. At a minimum, if the Commission chooses to proceed with the Pilot, it should exclude ETPs.

D. The broker-dealer data should be not be publically released even in an anonymized fashion.¹²

As currently structured, during the Pilot, each exchange that trades NMS stocks would publicly post a downloadable file on its website, containing sets of order routing data for the prior month. The Pilot also provides that the order routing data contain aggregated and anonymized broker-dealer order routing information. Further, the Pilot proposes that the SEC will provide each broker-dealer with a unique code. The SEC would also provide exchanges, on a confidential basis, a "Broker-Dealer Anonymization Key" that would supply the anonymization code for every broker-dealer whose order routing data would be included in the order routing data set. This key would be provided only to representatives of the Commission and the exchanges.

¹¹ See, Pilot at page 44, question 6.

¹² See, Pilot at page 95, question 58.



Virtu submits that the data related to broker-dealers should be gathered but not publicly released. Publication of this data, especially for a firm such as Virtu, could be used to identify Virtu’s activities in the market (despite anonymization efforts) causing significant harm to Virtu – particularly if market participants are able to use this information to reverse-engineer proprietary trading algorithms or strategies. In short, there is no conceivable reason why this specific broker-dealer information (even if anonymized) needs to be disseminated to the public as part of the Pilot. Moreover, we submit that because the exchanges are our competitors, the Anonymization Key should either not be provided to the exchanges or be significantly limited to a small number of key exchange staff under the strictest of confidentiality requirements.

E. The Pilot should include clearly defined measures to address the success or failure of the Pilot’s objectives.

At the outset, the Pilot should have plainly defined measures of success that can be measured at the Pilot’s conclusion. In other words, there should be established benchmarks against which the results of the Pilot can be assessed. We submit that the benchmarks are as important as the Pilot itself, and the industry should be afforded the opportunity to comment on those criteria. If the criteria upon which the Pilot’s success or failure are not clearly established, how can the industry fairly assess the results of the Pilot? In its current form, the Pilot propounds no such measures except for the fact that the gathered data will be analyzed and disseminated.

F. The Pilot should include appropriate deadlines for when the analysis of the Pilot will be released to the public for commentary and action.

The distribution of the Commission’s study of the Pilot’s results should have a firm deadline for publication (e.g. one-year from the completion of the Pilot’s final data collection). This will ensure that the Pilot does not continue in perpetuity without final results and actionable recommendations.

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Virtu appreciates this opportunity to comment on the Pilot. Please do not hesitate to contact me if you have any questions regarding any of the comments provided in this letter.

Sincerely yours,

A handwritten signature in black ink that reads "Douglas A. Cifu". The signature is fluid and cursive, with the first name being the most prominent.

Douglas A. Cifu
Chief Executive Officer

cc: The Honorable Jay Clayton, Chairman
The Honorable Michael S. Piwowar, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Robert J. Jackson, Jr., Commissioner
The Honorable Hester M. Peirce, Commissioner

Brett Redfearn, Director, Division of Trading and Markets
David S. Shillman, Associate Director, Division of Trading and Markets