FIA Principal Traders Group
2001 Pennsylvania Avenue NW
Suite 600 | Washington, DC 20006

T 202 466 5460
F 202 296 3184

ptg.fia.org

May 24, 2018

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

Re: File Number S7-05-18; The Securities and Exchange Commission proposal to conduct a Transaction Fee Pilot for National Market System stocks

Dear Mr. Fields:

The FIA Principal Traders Group ("FIA PTG")[1] appreciates the opportunity to comment on the above-captioned proposal ("Proposed Pilot"). While we have a long history of advocating for data-driven decision making, including the use of very carefully designed and structured pilot programs,[2] we have significant concerns with this proposal.

We initially expressed our concerns when the framework of the pilot was presented at the U.S. Securities and Exchange Commission's (the "Commission") Equity Market Structure Advisory Committee ("EMSAC") in April 2016.[3] At that time, we focused our comments on the complexity of the pilot and the costs that could be incurred with a program this complicated. While we remain troubled by the complexity and related costs, after a thorough review and analysis of the Proposed Pilot, we are most concerned that the data gathered from the pilot will not only fail to provide insight into the order-routing behavior of those handling customer orders but also could easily be misinterpreted and lead the Commission to reach erroneous conclusions. In addition, we have concerns with the duration and scope of the Proposed Pilot, the handling of Exchange-Traded

---

[1] FIA PTG is an association of firms, many of whom are broker-dealers, who trade their own capital on exchanges in futures, options and equities markets worldwide. FIA PTG members engage in manual, automated and hybrid methods of trading, and they are active in a wide variety of asset classes, including equities, fixed income, foreign exchange and commodities. FIA PTG member firms serve as a critical source of liquidity, allowing those who use the markets, including individual investors, to manage their risks and invest effectively. The presence of competitive professional traders contributing to price discovery and the provision of liquidity is a hallmark of well-functioning markets. FIA PTG advocates for open access to markets, transparency and data-driven policy and has previously made recommendations about a variety of equity market structure issues, including Regulation NMS (See https://ptg.fia.org/keywords/equity-market-structure).

[2] See FIA PTG Letter to the SEC on Pilot Programs – 061414.

[3] See FIA PTG Quick Byte on SEC Access Fee Pilot Program – 042516.

Products (ETPs), and the impact on holistic market structure reform, among other issues detailed in this letter. For all of these reasons, we urge the Commission to reconsider the Proposed Pilot before moving forward.

The Proposed Pilot Should Not Delay Comprehensive Market Structure Reform

FIA PTG has advocated for comprehensive market structure reform for years and has specifically called for a holistic review of Regulation National Market System ("Reg NMS") and its effects on markets since 2014.[4] While we recognize that this is a significant undertaking, we believe there are broad goals for market reform that enjoy substantial support from a wide variety of market participants. Those goals include:

1. Reducing complexity, order type proliferation and fragmentation;
2. Enhancing exchange competition;
3. Preserving the benefits of best execution for investors;
4. Enhancing the value of displayed quotes; and
5. Improving market transparency.

The recent proliferation of latency introducing mechanisms, such as IEX's "magic shoebox," has only increased the need for a comprehensive review. Rather than addressing the problems with the foundation of our market structure, exchanges have continued to add complex work-arounds including complicated order types and speed bumps. We strongly support any action by the Commission to address the fundamental issues in equity market structure, as suggested by Commissioners Pierce[5] and Stein,[6] without further delay. We fear that the national market system is now so complicated that it is not prudent to make piecemeal changes such as the ones contemplated by the Proposed Pilot.

The Proposed Pilot is Complicated, Expensive and Likely to Produce Misleading Results

Further to our recommendations for successful pilot programs,[7] FIA PTG is concerned with the lack of clarity regarding the objectives of the Proposed Pilot and how the Commission plans to define the pilot's success or failure. The Proposed Pilot seeks to gather a tremendous amount of

---

[4] See *FIA PTG Equity Market Structure Position Paper* (Sept. 30, 2014) available at https://ptg.fia.org/sites/default/files/content_attachments/FIA%20PTG%20Equity%20Market%20Structure%20Postion%20Paper%20-%20final.pdf; *FIA PTG Position Paper on Simplifying U.S. Equity Market Structure* (Jan. 28, 2015) available at https://ptg.fia.org/sites/default/files/content_attachments/FIA%20PTG%20Position%20-%20Simplifying%20US%20Equity%20Market%20Structure.pdf.

[5] See Commissioner Pierce's Remarks before the SIFMA Equity Market Structure Conference, Apr. 18, 2018.

[6] See Commissioner Stein's Remarks at the Meeting of the Equity Market Structure Advisory Committee, Apr. 5, 2017.

[7] See FIA PTG Letter on Pilot Programs (noting objectives should be clearly defined; time periods, including beginning and end should be defined; pilot programs should be conducted in rigid, single variable environments; results should be conducive to rigorous analysis; pilot programs introduce complexity to the marketplace and must be both constructed and introduced carefully; and pilot programs are a cost to the marketplace so should be used efficiently, and further that costs and benefits should be considered when determining duration and scale).

data at a significant cost. Exchanges and broker dealers, including liquidity providers like FIA PTG members, will incur substantial software development[8] and testing costs in order to comply with the complex structure of the Proposed Pilot. It is our understanding that the Proposed Pilot seeks to analyze the impact of rebates on the routing behavior of those representing customer orders, especially institutional orders. We do not believe the data produced by this pilot is the best way to achieve this, and even worse, we believe it may produce misleading results.[9] Using the proposed amended Rule 606 reports that were designed specifically to help asset managers and others assess routing effectiveness, coupled with Transaction Cost Analysis (TCA) information, would be a much better, safer, and more cost-effective way to assess routing conflicts. Accordingly, we do not find that the potential benefits of having this data justify the risks and costs of collecting it.

Proprietary Order Routing Data Will Be Made Public

In addition to our questions about the value of the data collected, FIA PTG has concerns about the required monthly posting of order routing data to public websites. While the Proposed Pilot requires exchanges to use unique, anonymized broker-dealer identification codes, we fear that over time the codes will be unmasked and individual broker dealers, including FIA PTG members, will be identifiable. The Commission states in the Proposed Pilot that it

> believes that the public availability of the order routing datasets would be useful to allow market participants, researchers, and others to conduct independent analyses of the proposed Pilot and its impacts. To the extent these analyses reveal useful information about the potential conflicts of interest associated with transaction-based fees and rebates and the effects that changes to those fees and rebates have on order routing behavior, execution quality, and market quality, the Commission believes it would use the resulting analyses for its own regulatory purposes to further inform itself and the public on whether further regulatory action in this area is appropriate.

As we stated previously, the analytical value of the data being collected is at best dubious, and thus the potential benefit of making this information public is not commensurate with the risks posed to firms' intellectual property. Accordingly, since the conflicts of interest that the Commission seeks to study are only relevant to agency trading, we request that routing data for orders marked as "principal" not be posted to public websites.

The Proposed Pilot Encourages Trading on Non-Displayed Venues

Reg NMS requires off-exchange trading to occur at prices at or better than the quoted national best bid or offer ("NBBO"). Access fee caps and related rebates enable exchanges to compete with non-exchange trading venues by essentially subsidizing the posted prices. In some instances, so-called "maker-taker fees" narrow displayed spreads, as the rebate for providing liquidity

---

[8] For example, exchange order entry specifications do not generally support a tag for held/not held (because this is a broker instruction). Accordingly, in connection with the Proposed Pilot, each exchange's order entry specifications will have to change, and every firm that routes orders to exchanges will have to update their gateways.

[9] Relying on CRD number-based data to analyze broker routing behavior will generate misleading results as the trades of various market participants could be aggregated under the same anonymized ID via direct market access arrangements.

effectively subsidizes the prices of displayed liquidity and narrows the NBBO, making it slightly more expensive to either match or improve upon those prices off-exchange.

FIA PTG favors proposals that encourage more trading on public, lit venues. The rebates offered to liquidity providers as an incentive to publish "out loud" their willingness to transact are one of the few benefits liquidity providers realize when quoting on exchange relative to providing liquidity on dark venues. This is particularly important in today's equity markets where Reg NMS has facilitated the growth of off-exchange trading and resulted in nearly forty percent of all volume occurring away from exchanges. We worry that removing rebates without making other changes to the overall economics will tilt the balance towards off-exchange venues and further encourage trading away from public, lit markets.

The Duration of Proposed Pilot is Too Long and Scope is Too Broad

The length and size of the Proposed Pilot are more appropriate for a rule implementation than an experimental trial. For the reasons stated above, we believe the length and scope of the Proposed Pilot should be as short and narrow as possible. FIA PTG suggests that the pilot be shortened to six months with three-month pre- and post-pilot periods. Additionally, we suggest limiting the included NMS stocks to 100 per bucket (test groups and control group), which would be consistent with the recommendations made by the EMSAC.

ETPs should be Excluded from the Proposed Pilot, or at a Minimum Handled Separately

The Proposed Pilot presents specific challenges that could impact ETPs. Issuers of ETPs are judged by the market quality of their products. Some ETPs may be inside the Proposed Pilot, while other, very similar ETPs may be outside of the Proposed Pilot. This will impact relative market quality statistics such as quoted bid-ask spreads and will be problematic for issuers. Accordingly, ETPs should either be excluded completely from the Proposed Pilot or grouped separately so that like products are all treated the same. In addition, existing rebate programs that pay market makers for providing liquidity in ETPs (*e.g.*, LMM, ELP, LMP) should be exempt.[10]

The Inclusion of Canadian Interlisted Stocks should be Carefully Considered

The Proposed Pilot does not appear to contemplate how Canadian interlisted stocks should be handled. Similar to the aforementioned concern with ETPs, FIA PTG is concerned that the inclusion of Canadian interlisted stocks in either one of the reduced access fee or no rebate test groups may materially impact order flow by encouraging transactions to move away from U.S. exchanges and on to Canadian exchanges.

Overlapping with the Tick Size Pilot is Problematic

If the Commission decides to move forward with the Proposed Pilot, it must not be started until the Tick Size Pilot has been completed. Expecting industry participants to manage these potentially overlapping pilots is unreasonable, and the simultaneous implementation of both pilots will compromise the data collection of each.

[10] To the extent that similar liquidity provider rebate programs exist in non-ETP products, those should be exempt as well.

The Inclusion of Protected Quote and Trade-At Test Groups would not Resolve Our Concerns with the Pilot Proposal

On the one hand, as part of the holistic market structure reform we have long advocated for, FIA PTG values discussions, pilots, etc. on the impact of trade-at, eliminating order protection and lifting the ban on locked and crossed markets. Accordingly, it would be easy for us to support adding these concepts to the Proposed Pilot. On the other hand, in respect of the Proposed Pilot, adding any of them would significantly increase the complexity of what is already an overly complex and costly initiative. Thus, while we generally may support these types of initiatives, they would not resolve our many stated concerns with this pilot.

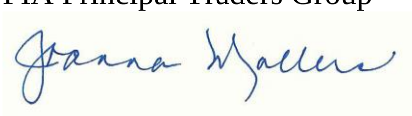
Conclusion

The Proposed Pilot, as designed, is not ideal for its stated goal. It will not facilitate analysis of how rebates impact the routing behavior of institutional investors. Even more troubling, the results could be misleading, and the public posting of this data could reveal valuable proprietary information. Moreover, the cost and complexity of this pilot raise serious concerns with its implementation. Equity market structure has become so complicated and tangled that pulling a single string through a pilot like this could create a gordian knot that is impossible to untie. We strongly urge the Commission to reconsider this approach and instead focus on comprehensive market structure reform.

If you have any questions about these comments, or if we can provide further information, please contact Joanna Mallers ([redacted]).

Respectfully,

FIA Principal Traders Group



Joanna Mallers
Secretary

cc: Walter J. Clayton, Chairman
Michael S. Piwowar, Commissioner
Kara M. Stein, Commissioner
Robert J. Jackson, Jr., Commissioner
Hester M. Peirce, Commissioner
Brett W. Redfearn, Director of the Division of Trading and Markets