RBC Capital Markets®

RBC Capital Markets, LLC
Global Equity
Three World Financial Center
200 Vesy Street, 8th Floor
New York, NY 10281

May 24, 2018

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

Re: Proposed Rule to Establish a Transaction Fee Pilot for National Market System Stocks, File No. S7-05-18

Dear Mr. Fields:

Royal Bank of Canada (RBC) appreciates the opportunity to comment on the above-referenced proposed rule ("the Proposal") to establish a pilot program to assess the impact of transaction fees and rebates on order routing behavior, execution quality, and market quality for National Market System ("NMS") stocks ("the Pilot").

RBC, headquartered in Toronto, Ontario, is a global provider of financial services, including personal and commercial banking, wealth management services, corporate and investment banking, and life insurance and transaction process services. RBC's approximately 80,000 employees serve more than 16 million personal, business, public sector, and institutional clients worldwide through offices in Canada, the United States, and 36 other countries. In the United States, RBC's approximately 12,300 employees primarily provide corporate and investment banking, wealth management, asset management, and retail banking services to customers and clients in more than 40 states.

RBC Capital Markets (RBCCM) is the investment banking platform of RBC. RBCCM is a U.S. registered broker-dealer engaged in, among other things, providing equities trading and execution services to retail and institutional investors. These investors include large investment managers with trillions of dollars in assets under management. Those assets reside in employee pension funds, mutual funds, and other vehicles that hold the savings of individual investors.

Similarly, RBC Global Asset Management (RBCGAM) is an asset manager with offices in Canada, the U.S., Europe, and Asia. Its approximately 1,300 employees, including over 300 investment professionals, manage more than $330 billion in assets. In the U.S., RBCGAM is a federally registered investment adviser and manages over $35 billion of assets for corporations, public and private pension plans, Taft-Hartley and union plans, charitable institutions, foundations, endowments, municipalities, registered mutual funds, private investment funds, trust programs, foreign funds such as UCITS funds, individuals, wrap sponsors and other U.S. and international institutions.

The U.S. operations of both RBCCM and RBCGAM work every day to successfully invest the hard-earned savings of millions of Americans – savings that those Americans put to work to build and grow businesses, to purchase a home, to educate their children, and to prepare for a secure retirement. This letter is written on behalf of both RBCCM and RBCGAM.

Our comments on the proposal can be found below.

1. Overview:

RBC strongly supports the Proposal and commends the Commissioners and staff for the thoughtful and thorough work that it reflects. If adopted by the Commission essentially as proposed, and if implemented effectively, the Pilot should provide data to enable the Commission to determine the impact of transaction-based fees and rebates on order routing behavior, on execution quality, and on market quality. That data can in turn be used by the Commission to support appropriate reforms to U.S. equity market structure.

When Chairman Clayton presented the Proposal to the Commission in March, he said that "we do not currently have data to help us meaningfully analyze the effects of exchange fees and rebates on order routing behavior, execution quality, and our market structure generally. I believe that the pilot proposal that the staff is presenting today would help us address this data gap. In my view, the proposed pilot, if adopted, would lead to a more thorough understanding of these issues, which would help the Commission make more informed and effective policy decisions in the future, all to the benefit of retail investors."[1] We agree with the Chairman. In particular, we believe that the Proposal will provide valuable data to the Commission to determine the extent to which the current practice of "maker-taker" pricing is contributing to price opacity, market complexity, and conflicts of interest between brokers and clients, and thereby help the Commission to ensure that U.S. equity markets are more transparent, efficient, and fair for all investors.

2. Process:

We appreciate the Commission's decision to issue the Proposal as a proposed rule rather than as an NMS plan. This decision will encourage input from multiple and diverse stakeholders, and thereby help to ensure that the Pilot fulfils its purpose. In addition, by choosing to release a proposed rule rather than an NMS plan, the Commission has taken a meaningful step to enhance the transparency of its rulemaking process, which will give the Pilot added credibility if and when finalized.

3. Content:

[1] Chairman Jay Clayton, SEC, Statement at Open Meeting on Proposed Rule to Conduct a Transaction Fee Pilot in NMS Stocks, March 14, 2018, available at https://www.sec.gov/news/public-statement/statement-clayton-open-meeting-nms-2018-03-14.

a. No-Rebate Test Group:

The Proposal's no-rebate Test Group – i.e., Test Group 3 -- is an essential feature of the Pilot. As the Proposal itself says, "if rebates create a conflict of interest for broker-dealers when they decide where to route an order to post or take liquidity, and if those conflicts have an effect on order routing behavior, execution quality, or market quality, then only a complete prohibition on rebates will allow the Commission to study directly these conflicts and their effects . . . ."[2] Only by having a test group where no rebates are permitted (and where the impact of prohibiting rebates can be isolated) can the Pilot gather useful data about the impact of rebates on order routing behavior, execution quality, and market quality. We applaud the Commission's decision to include a no-rebate bucket in the Proposal, and we urge that it be retained and included in the Pilot.

b. Linked Pricing:

In addition to prohibiting rebates, Test Group 3 of the Pilot would also prohibit exchanges from offering a discount or incentive on transaction fee pricing "applicable to removing (providing) liquidity on the exchange that is linked to providing (removing) liquidity on the exchange ("Linked Pricing")".[3] We fully support this prohibition. It is consistent with our view, previously conveyed to the Commission, that "a pilot that limits or prohibits the economic incentive of rebates . . . without similarly restricting other inducements to trade, runs a serious risk of actually encouraging the use of such inducements and thereby undermining the integrity of the pilot."[4] For that reason, we believe that the prohibition on Linked Pricing should, if anything, be expanded to include a prohibition on any other inducements to trade, regardless of whether they are related to fee pricing. These inducements may include payment for order flow as well as market data discounts, among others. Just as the Proposal prohibits Linked Pricing models from Test Group 3 because of their potential to distort order routing, execution quality, and market quality, so should it prohibit other inducements to trade that hold that same potential. To the maximum extent possible, Test Group 3 should aim to ensure that trades are executed solely on the basis of transparent pricing of a stock.

c. Covered Trading Venues:

We agree with the Commission that the Pilot "should be designed to broadly study the impact of transaction fees and rebates on order routing behavior, execution quality, and market quality."[5] We further agree with the Commission that, in order to advance this objective of a broad study, the Pilot should apply to inverted exchanges as well as to traditional exchanges. This approach

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[2] Transaction Fee Pilot for NMS Stocks, 83 FR 13008 (March 26, 2018) (hereinafter "Proposal"), at 54, available at https://www.federalregister.gov/documents/2018/03/26/2018-05545/transaction-fee-pilot-for-nms-stocks.
[3] *Id.* at 57-58.
[4] RBC Capital Markets Comment Letter, September 23, 2016, https://www.sec.gov/comments/265-29/26529-86.pdf at 3.
[5] Proposal at 31.

is both logical and feasible, given that all equities exchanges assess fees that are subject to the Exchange Act and its rule filing requirements.

The Proposal does not, however, apply to ATSs or other non-exchange trading venues because pricing on these venues is not subject to access fee caps or other substantive and process requirements under Reg NMS Rule 610. As the Proposal states, "To the extent ATSs do not charge transaction-based fees, it is not practicable to include them in a pilot that is structured to test the impact of changes in transaction fees."[6] We understand the complexities involved in applying the Pilot to non-exchange venues. At the same time, we are concerned that completely exempting non-exchange venues could inadvertently cause omissions from or distortions of data produced by the Pilot. In fact, the Proposal itself appears to acknowledge that possibility insofar as it says that, by excluding ATSs and other non-exchange venues, the Pilot could incentivize liquidity providers to move their quotes to other venues.[7] In order to reduce the possibility of data omissions or distortions, the Pilot could be tailored to apply to ATSs and other non-exchange venues. Even if the provisions of the Pilot applicable to exchanges cannot be simply and neatly extended to non-exchanges, there should be some way to at least monitor the effects of the Pilot on these venues, such as disclosure of fees and rebates; how stock prices, fees, rebates, and volumes may change over time; and whether and to what extent there are changes in patterns with respect to the provision and/or cost of other services. In this regard, we note that the Commission has proposed the "Regulation of NMS Stock Alternative Trading Systems"[8] This proposal, if adopted[9], would make the operation of ATSs more transparent to the Commission, to ATS participants, and to the public at large. This enhanced transparency regime, if in place when the Pilot is commenced, would help identify any impacts of the Pilot on ATS practices and liquidity.

d. Data Collection and Publication:

The Proposal would require "each equities primary listing exchange to publicly post on its website downloadable files containing a list of its primary listed securities included in the proposed Pilot as well as an updated cumulative list of all changes to any Pilot Security for which it serves as the primary listing market. An exchange would have to include this information on its website as downloadable files that are freely and persistently available and easily accessible by the general public. In addition, the information must be presented in a manner that facilitates access by machines without encumbrance by user name, password, or other access constraints and the files and information therein could not be subject to any usage

[6] *Id.* at 32.
[7] *See id.* at 33.
[8] *See* Regulation of NMS Stock Alternative Trading Systems, 80 FR 80997 (December 28, 2015), available at https://www.federalregister.gov/documents/2015/12/28/2015-29890/regulation-of-nms-stock-alternative-trading-systems.
[9] In addition to the disclosures that would be required by the proposal, we believe that the final regulation should include disclosure of rebates, as well as fees, in order to assess their impact on order routing, execution quality, and market quality.

restrictions, such as restrictions on access, retrieval, distribution, and reuse."[10] Further, the Proposal would require exchanges to "publicly post downloadable files containing . . . order routing information", and to post this information "on a website that is freely and persistently available and easily accessible by the general public."[11] This data would be produced at the broker-dealer level on an anonymized basis.

We strongly support these data collection and publication features of the Pilot. They will facilitate greater accuracy of the data. They will also encourage more thorough analysis of the data. Most importantly, they will produce data and analyses that serve the core purpose of the Pilot: to permit the Commission to assess the potential conflicts of interest, opacity, and fragmentation 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.

In addition, we would recommend requiring disclosure of the transaction fee and/or rebate that was applied most frequently (i.e., the mode) by each exchange. Disclosure of this information would enable a more accurate comparison of the fees and rebates most often applied by each exchange.

e. Characteristics and Scope of Securities:

We agree with the Commission's decision that the securities in the Pilot should have an initial minimum $2 per share price threshold at the time of the initial stock selection.[12] This threshold will capture virtually all NMS stocks while minimizing the risk that securities will drop out of the Pilot because they fall below $1 per share, which, as the Proposal states, is unusual for securities priced at $2 or more. By minimizing the risk of drop-outs, the $2 share price threshold will help ensure consistency among the Test Groups and limit the risk of data anomalies due to changes in the composition of those groups.

The Proposal would not establish a minimum market capitalization for securities in the Pilot Test Groups, in order that the Commission can obtain actual data about the impact of fees and rebates on small- and mid-cap stocks, rather than make inferences based on a review of data from large-cap stocks.[13] That intention is understandable. However, we share the view of other market participants and analysts that the impact of rebates and fees on order routing, execution quality, and market quality is primarily a concern around the trading of larger, more liquid securities.[14] Including in the Pilot hundreds, if not thousands, of less liquid securities could have two negative impacts: first, the available liquidity for those securities could be adversely affected; and second, the extent to which fees and rebates – rather than price movements – affect trading behavior and overall market quality in connection with more liquid securities could be more difficult to assess.

[10] Proposal at 70-71.
[11] *Id.* at 88-89.
[12] *See id.* at 38.
[13] *See id.* at 39-41.
[14] *See id.* at 40, n.106-107.

For these reasons, we believe that the majority of securities within the Test Groups should be more liquid. To the extent less liquid securities are included, they should be a minority of all securities in the Test Groups.

Similarly, we do not believe that, as a general matter, firms should be allowed to opt out of the Pilot. Such a policy would, in our view, adversely affect the quality of the data and the credibility of the Pilot. It could also potentially allow firms – including those with the largest, most liquid securities – to gain a potentially unfair advantage over competitors that decide not to opt out. Indeed, such a policy would create a perverse incentive for firms to opt out. If any opt-out policy is adopted as part of the Pilot, it should apply on a limited basis to less liquid securities that credibly claim that inclusion in the Pilot would adversely affect trading of those securities.

f. Duration:

We support the Proposal's provisions relating to the duration of the Pilot. In our view, a pilot of at least one year and no more than two years will ensure that ample data is collected over time, that the restrictions of the various Pilot Test Groups cannot be evaded by delay, and that the Pilot does not exist for a period of time beyond which its data would be cumulative or of marginal significance relative to data produced earlier in the Pilot period.

4. Looking Forward: Potential Results, Reforms, and Benefits to Investors

Should the Pilot be implemented as proposed and consistent with these comments, and should the data show that fees and rebates are adversely affecting order routing, execution quality, and market quality, then we believe that the Commission should consider a number of reforms, including the following:

First, adoption of a final order handling rule that discloses fees and rebates in connection with institutional orders, as currently proposed[15];

Second, adoption of a final version of Rule ATS-N requiring a disclosure of an NMS Stock ATS's fees, rebates, and other charges; and

Third, a substantial limitation, if not prohibition, on rebates for more liquid securities where data supports the conclusion that liquidity incentives are no longer necessary.

These reforms are targeted and limited. They would not add significantly to the regulatory burden of the Commission or of market participants. And they would further the Commission's mission to protect investors; to maintain fair, orderly, and efficient markets; and to facilitate capital formation.

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[15] *See* Disclosure of Order Handling Information, 81 FR 49431(July 27, 2016), available at https://www.federalregister.gov/documents/2016/07/27/2016-16967/disclosure-of-order-handling-information.

5. Conclusion

The Commission's proposal for a transaction fee pilot study is a carefully crafted, logical, modest, and data-driven step toward making U.S. equity markets more transparent, more efficient, and less conflicted. RBC applauds the Commission's action in putting the Proposal out for comment. We encourage continued progress in finalizing and implementing the Proposal, and we stand ready to provide the Commission with any additional information as it moves the Proposal forward.

Thank you for your consideration of our views.

Sincerely,

Rich Steiner
Electronic Trading Strategist