200 West Street | New York, New York 10282
Tel: 212 902-1000

Goldman Sachs

May 24, 2018

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 (File No. S7-05-18)

Dear Mr. Fields:

Goldman Sachs & Co. LLC ("Goldman Sachs") appreciates the opportunity to comment on the U.S. Securities and Exchange Commission's ("SEC" or "Commission") proposed Transaction Fee Pilot for NMS stocks (the "Pilot") to study the effects that changes to transaction-based fees and rebates may have on order routing behavior, execution quality, and market quality.[1] The Pilot calls for, among other things, a two-year pilot program in NMS stocks using three test groups that would modify the current $.0030 per share access fee cap (the "Fee Cap") for executions on exchanges.[2]

We firmly support increased price transparency of displayed quotations[3] and believe that an appropriately calibrated Fee Cap is vital to improving U.S. equity market structure. However, while we applaud the Commission's focus on reform in this area, we are concerned that a lowered Fee Cap will be postponed for years while the industry awaits the results of a Pilot. **We believe that there is broad recognition that a lower Fee Cap is needed, and that a Pilot, which will be lengthy, complex and costly, will not yield a different conclusion in two to three more years. In our view, a reduction in the Fee Cap from $.0030 to $.0010 per share could be supported today and would be better calibrated with present-day trading and execution costs, which have decreased substantially since 2005 when the current Fee Cap was adopted.** We believe that such an adjustment would be reasonable and would bring some

[1] Securities Exchange Act Release No. 82873, 83 FR 13008 (March 26, 2018) (the "Proposing Release").

[2] 17 CFR 242.610(c)(1). The Pilot would have a control group plus three test groups that would modify the Fee Cap as follows: (1) 15-cents per 100 shares; (2) 5-cents per 100 shares; and (3) a ban on rebates. The last group, however, would retain the existing Fee Cap for fees for marketable orders. Id. at 13015.

[3] We have had a longstanding position advocating for increased price transparency for displayed quotations. See Letter from Gary Cohn, Managing Director, Goldman Sachs, to Johnathan G. Katz, Secretary, Commission at 10 (July 19, 2004) ("[w]e fully endorse the pivotal position of price transparency in efficient price discovery."); Letter to Elizabeth M. Murphy, Secretary, Commission at 14 (June 25, 2010) ("[w]e are also generally concerned that the lack of transparency regarding per-share fees and rebates undermines the integrity of displayed quotations."); Remarks of Paul M. Russo, Global Co-Chief Operating Officer of Equities, Goldman Sachs, at Equity Market Structure Advisory Committee (April 5, 2017) (noting that access fees have "been mentioned by almost everybody as the biggest distortion in the marketplace.").

immediate benefits to equities markets with respect to price transparency and addressing potential conflicts of interest.

We also believe that, concurrent with a reduction in the Fee Cap, the Commission should conduct an abbreviated study of the effects of a prohibition on rebates as described in Pilot Test Group Three of the Proposing Release. We believe rebates may contribute to pricing distortion, market complexity and fragmentation and, if so, eliminating them would promote greater safety and soundness of the capital markets. For this specific question, an abbreviated study would provide the requisite insight.

Better Market Transparency

In adopting the Fee Cap as part of Regulation NMS in 2005, the Commission stated:

> "For quotations to be fair and useful, there must be some limit on the extent to which the true price for those who access quotations can vary from the displayed price."[4]

In the thirteen years since the Commission adopted the Fee Cap, spreads have considerably narrowed[5] and commission rates have contracted.[6] However, the Fee Cap has remained unadjusted. There is a well-developed, general consensus amongst market participants that a $.0030 per share Fee Cap is an outdated benchmark for execution costs in today's trading environment.[7] As a limit, it creates an upper-range that is simply too high and far from representative of true prices in the marketplace.

---

[4] Securities Exchange Act Release No. 51808, 70 FR 37495, 37584 (June 29, 2005) ("Regulation NMS Adopting Release"). The Commission noted that the purpose of the Fee Cap was primarily to prevent an "outlier" exchange from charging an exorbitant fee to access a protected quotation. Id. at 37503.

[5] See Mary Jo White, Chair, Commission, Speech at the Sandler, O'Neill & Partners, L.P. Global Exchange and Brokerage Conference (June 5, 2014) ("the spreads between bid and ask prices for the broader market also are as narrow as they have ever been.").

[6] See, e.g., James Angel, Lawrence Harris & Chester Spatt, "Equity Trading in the 21st Century," Quarterly Journal of Finance 1, (2011) ("[r]etail commissions have fallen substantially and continue to fall."); Financial Industry Regulatory Authority Regulatory Notice 11-08 (February 2011) (noting FINRA's belief that "competition, market pricing efficiency and automation generally have reduced markups, markdowns and commissions materially below 5 percent" of the total value of the transaction). In addition, a review of TABB Group's annual "US Institutional Equity Trading Study" for previous years indicates that average commission rates (as reported by over 100 asset management firms) during 2005 - 2017 for various execution channels have, with little year-over-year variation, generally declined since 2005 with the largest decline (approximately 68%) for the DMA/Algorithms execution channel. See e.g., Larry Tabb, Valerie Bogard, Dayle Scher, TABB Group, "US Institutional Equity Trading Study" (April 4, 2017).

[7] See e.g., Joe Ratterman, Chief Executive Officer, & Chris Concannon, President, BATS, "Open Letter to U.S. Securities Industry Participants Re: Market Structure Reform Discussion," at 1, 8 (January 6, 2015) (calling for a "greater than 80% fee reduction in the access fee cap" and tiered access fees starting at $.0005); Bradley Hope & Scott Patterson, "NYSE Plan Would Revamp Trading," WALL ST. J. (December 17, 2014) (describing NYSE's proposal to lower the Fee Cap and eliminating maker-taker pricing in conjunction with imposing a "trade at" requirement); Randy Snook, Executive Vice President of Business Policies and Practices, SIFMA, "Taking Stock of Equity Market Structure Priorities" (May 1, 2018) ("SIFMA has supported lowering the current cap on access fees . . . ."); Curt Bradbury, Market Structure Task Force Chair, Board of Directors, SIFMA, and Kenneth E. Bentsen Jr., President and Chief Executive Officer, SIFMA, Opinion, "How to Improve Market Structure," N.Y. TIMES (July 14, 2014).

The maker-taker pricing models that have developed under the current Fee Cap regime further undermine the SEC's stated goal in 2005 and contribute to pricing distortion in the market.[8] Maker-taker pricing models typically profit by capturing the difference between the access fee collected and the rebate paid to the liquidity provider (the "net capture rate").[9] Thus, displayed prices do not reflect the actual economic costs because exchange fees and rebates are not reflected in those prices. We believe that reducing the Fee Cap from $.0030 per share to $.0010 per share would advance the effort to improve transparency because market participants could have greater confidence that the displayed price more accurately reflects the actual costs of execution.

In support of $.0010 per share as a reasonable Fee Cap, we note that the Commission originally proposed a $.0010 per share Fee Cap for individual trading centers, before settling on $.0030.[10] We think it is also compelling that $.0010 per share is the mean level of Fee Cap testing limits in the Proposing Release, i.e., Test Group 1 ($.0015 per share) and Test Group 2 ($.0005 per share).

Perhaps the most persuasive support for $.0010 per share as a reasonable level is a comparison to the present day levels of exchanges' net capture rates. A review of the fee schedules of major maker-taker exchanges as of May 1, 2018, indicates that the average net capture rate between their base-level fee/rebate tier and their highest level fee/rebate tier is approximately $.0005 per share.[11] At a $.0010 per share Fee Cap, the range within which exchanges could set fees and rebates would narrow, and fee schedules would be less varied across the exchanges. However, exchanges could still choose to offer rebates to incentivize liquidity provision and maintain their current net capture rates.[12]

Mitigation of Potential Conflicts of Interest

The Fee Cap at its current level may also create misaligned incentives and potential conflicts of interest for broker-dealers' routing and execution decisions.[13] As studies have

---

[8] See id. See also Larry Harris, "Maker-Taker Pricing Effects on Market Quotations," at 24-25 (Nov. 14, 2013); Stanislav Dolgopolov, "The Maker-Taker Pricing Model and its Impact on the Securities Market Structure: A Can of Worms for Securities Fraud?", 8 VA. L. & BUS. REV. 231, 270 (2014).

[9] For example, if an exchange charges an access fee of $0.0030 and rebate of $0.0025, the exchange's net capture rate would be $.0005. See Proposing Release at n.126.

[10] See Regulation NMS Adopting Release at 37502-503.

[11] We note that the actual net-capture rate for each exchange may differ from the average net capture rate across its fee/rebate tiers, if, for example, an exchange had greater volume in a tier that provided a higher net capture rate.

[12] For example, if the Fee Cap were set at $.0010 per share, a maker-taker exchange could charge a take fee of $.0010 per share and offer a maker rebate of $.0005 per share, yielding the same $.0005 per share net capture rate.

[13] See White supra note 5 (noting that "[a]nother source of broker conflicts is the large number of complex order types offered by the exchanges," the majority of which "are designed to deal with the maker-taker fee model and the SEC's rule against locking quotations."). See also Conflicts of Interest, Investor Loss of Confidence, and High Speed Trading in U.S. Stock Markets: Hearing Before the Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, 113 Cong. 413 (2014). Conflicts of interest in routing have also increasingly been the subject of regulatory examinations. See e.g., FINRA, Order Routing Conflicts (November 2017) (noting FINRA's review of the impact of order routing inducements on order routing practices and decisions).

suggested, broker-dealers may elect to post non-marketable limit orders on market venues offering the highest rebate and bypass those venues where there is greater likelihood of execution, but a higher access fee.[14] By maintaining the Fee Cap at the level adopted in 2005 as spreads have narrowed and commissions have decreased over the past 13 years, these misaligned incentives and potential conflicts of interest have grown. An immediate reduction in the Fee Cap to $.0010 per share would reduce the effect of these misaligned incentives and the potential conflicts of interest.

A Study of Rebates in Lieu of a Pilot

In lieu of the Pilot, and concurrent with the lowering of the Fee Cap, we encourage the Commission to conduct an abbreviated study of the effects of eliminating rebates similar to the criteria of Pilot Test Group Three. We believe that rebates introduce complexity because market participants are incentivized to maximize their collection of rebates. This behavior fosters the proliferation of maker-taker models, which further contributes to market complexity. By eliminating rebates, routing decisions should become more simplified, which, in turn, should enhance the overall safety and soundness of our financial system.[15]

A Pilot Postpones Well-Recognized and Needed Relief

As proposed, the Pilot would last two years[16] with a six-month pre-pilot and six-month post-pilot period. Conservatively, it will take the Commission at least one to two years after the conclusion of the Pilot to analyze the results, propose amendments to the Fee Cap, and adopt such amendments. This means that if the Pilot began tomorrow, we are at least four years away from meaningful reform to the Fee Cap.[17]

For the reasons stated above, we believe that there is broad support in favor of lowering the Fee Cap today, and that the Pilot will not yield a different conclusion. We also believe that a reduction of the Fee Cap to $.0010 per share is reasonable and would be better calibrated with today's market pricing.

* * *

[14] See Robert H. Battalio, Shane A. Corwin and Robert H. Jennings, "Can Brokers Have It All? On the Relation Between Make-Take Fees and Limit Order Execution Quality," Journal of Finance 71, 2193-2237 (2016).

[15] We have previously voiced concerns regarding the complexity of securities markets. See e.g., Letter from Paul M. Russo, Managing Director, Securities Division, Goldman Sachs, to Brent Fields, Secretary, Commission (Jan. 12, 2016) (noting that "speed, coupled with U.S. equity market fragmentation of non-differentiated exchanges, has resulted in an overly complicated marketplace.").

[16] The duration of the Pilot is two years with an automatic sunset at one year unless the Commission publishes a notice to continue for another year. See Proposing Release at 13025.

[17] As a baseline comparison, the Commission's issued its initial order directing self-regulatory organizations to establish the Tick Size Pilot Program on June 24, 2014. See Securities Exchange Act Release No. 72460 (June 24, 2014), 79 FR 36840 (June 30, 2014). The post-pilot data collection period for the Tick Size Pilot Program is scheduled to end on April 1, 2019, approximately 4 years and 9 months after the Commission's initial order. See FINRA Tick Size Pilot Implementation Timeline, available at http://www.finra.org/industry/tick-size-pilot-implementation-timeline.

In conclusion, we support an immediate reduction of the Fee Cap to $.0010 per share, and a concurrent study of the effects of eliminating rebates. We encourage the Commission to solicit specific comment on this suggested approach and provide a brief extension of the comment period for others to be afforded the opportunity to share their views. We appreciate the opportunity to comment on this very important proposal.

Sincerely,

Paul M. Russo
Managing Director

cc: Jay Clayton, Chairman
Michael S. Piwowar, Commissioner
Kara M. Stein, Commissioner
Robert J. Jackson Jr., Commissioner
Hester M. Peirce, Commissioner
Brett Redfearn, Director, Trading and Markets
David Shillman, Associate Director
John Roeser, Deputy Associate Director
Richard Holley III, Assistant Director
Daniel Gray, Senior Special Counsel, Division of Trading and Markets