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Via email: rule-comments@sec.gov

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

Re: SEC Proposed Transaction Fee Pilot for NMS Stocks (File No. S7-05-18)

Dear Mr. Fields:

State Street Global Advisors is pleased to submit our comments to the Securities and Exchange Commission ("Commission") on the proposed Transaction Fee Pilot for NMS Stocks.[1] With over $2.7 trillion in assets under management, State Street Global Advisors is the world's third-largest asset manager and the issuer of the SPDRs family of exchange-traded funds (ETFs). Consequently, we support initiatives that promote resilient markets with robust liquidity where clients can execute investment decisions with confidence.

We support conducting a Transaction Fee Pilot that will enable an assessment of how changes to Rule 610(c) of Regulation NMS may affect the marketplace. As the Commission's Equity Market Structure Advisory Committee ("EMSAC") stated in its recommendation for an Access Fee Pilot in 2016, "definitive conclusions on access fee modifications are difficult to draw without an actual implementation."[2]

While we support the concept of the pilot broadly, we believe the Commission and marketplace would benefit from more clear definition of the measurement criteria for the pilot. We also believe the pilot may present certain risks, some of which could be mitigated in the design of the pilot. We recommend several modifications to the proposal in an effort to protect investors including:

- Reducing the number of securities in the pilot;
- Excluding exchange-traded products ("ETPs") from the pilot; and
- Including early termination criteria for the pilot.

More detailed discussion of our views and recommendations follows below.

<u>Our Perspective</u>

The US equity market structure generally works well for issuers and investors. Regulation NMS has promoted efficiency, transparency, and resilience in the marketplace, ultimately benefitting investors; however, the cap on exchange access fees, which is a key component of Regulation NMS, has generated legitimate controversy in today's equities markets.

1 SEC Release No. 34-82873 (March 14, 2018), available at: https://www.sec.gov/rules/proposed/2018/34-82873.pdf.

2 SEC Equity Market Structure Advisory Committee Recommendation for an Access Fee Pilot (July 8, 2016), available at: https://www.sec.gov/spotlight/emsac/recommendation-access-fee-pilot.pdf.

We recognize that there are some disadvantages of the maker-taker pricing model used by US equities exchanges.[3] Drawbacks include the potential for fees and rebates to create order routing conflicts for broker-dealers, create structural complexity in the marketplace, and undermine price transparency.[4] Additionally, the access fee cap imposed by Rule 610(c) should be revisited from time to time as the industry evolves. Competitive forces have failed to compress access fees even though exchanges compete vigorously for order flow. This likely occurs because access fees help fund rebates paid by exchanges to attract displayed liquidity. (As the EMSAC highlighted, “the largest exchanges in terms of volume are those that charge access fees at or near the cap and, hence, pay the highest rebates to attract displayed liquidity.”[5])

Maker-taker pricing, despite the criticisms, provides important benefits to issuers and investors in US equities markets. Exchanges use rebates as a tool to promote displayed liquidity and price discovery, which results in competitive bid-ask spreads, saving transaction costs that investors may otherwise incur. The ability to pay rebates also enables listing exchanges to incentivize market makers to undertake enhanced quoting obligations for the opportunity to earn higher rebates. In the case of ETPs, the existence of competitive “Lead Market Maker” programs operated by exchanges increases confidence that investors will have a positive experience when seeking liquidity in the marketplace. One of the many benefits of exchanges operating these programs is the presence of transparent programs which are standardized at each exchange.[6]

In light of the possibility that reducing access fees and eliminating rebates could worsen market quality and harm investor experience in the equities markets, we support evaluating the effects of these actions through a carefully constructed pilot program before drawing conclusions about the need for policy change. Data generated from the pilot will help to inform the broader discussion about how to promote market quality for issuers and investors.

Define Measurement Criteria for the Pilot

Although one of the stated goals of the pilot is to test whether rebates create a conflict of interest for broker-dealers when routing customer orders, we recognize that changing access fees and rebates will not eliminate routing conflicts. We suggest focusing the goals of the pilot on improving market quality and investor experience. Additionally, the Commission should specify measurement criteria for the pilot in advance. We suggest including the measurement criteria recommended by the EMSAC.[7] Those criteria included: bid-ask spreads; displayed liquidity and depth of liquidity; volatility; hidden liquidity on- and off-exchange; trading volume; order routing behavior; price improvement; locked/crossed markets; slippage and

[3] Maker-taker pricing is the prevailing fee structure among the largest US equities exchanges. The exchange pays its broker-dealer participants a per share rebate to provide liquidity and assesses a fee to remove liquidity.

[4] See SEC Memorandum on Maker-Taker Fees on Equites Exchanges from the Commission’s Division of Trading and Markets to the EMSAC (October 20, 2015), available at: https://www.sec.gov/spotlight/emsac/memo-maker-taker-fees-on-equities-exchanges.pdf.

[5] See Supra note 2.

[6] For more discussion on this topic, see our comments on FINRA’s Retrospective Review of Rule 5250 available at: http://www.finra.org/sites/default/files/notice_comment_file_ref/17-41_SSGA_comment.pdf.

[7] See Supra note 2.

price impact; retail and institutional commission pricing; exchange order type usage; ATS pricing; and others.

With respect to routing conflicts, one of the most effective ways to address the issue is through transparency. To that end, we urge the Commission to issue final rules on order routing disclosure as soon as possible. Increasing and standardizing this information will go a long way towards giving investors better tools to evaluate and engage with broker-dealers regarding order routing practices in general.[8]

Reduce the Number of Securities in the Pilot

The Commission proposed to place 1,000 securities in each of three test groups. Although the net effects of the pilot are uncertain, there is risk of potential negative effects, particularly in the no-rebate bucket where the possibility of spread widening is especially acute. The Commission should balance the desire to produce a meaningful dataset against the risks of over-inclusion. We are concerned that if market quality deteriorates in any of the test groups, having 1,000 securities in each test group could result in unjustifiable costs to the market, ultimately absorbed by investors. The Commission should consider the EMSAC's recommendation to include 100 securities in each test group.[9]

Exclude ETPs from the Pilot

The Commission proposed to include ETPs in the pilot alongside common stocks and other securities. We recommend excluding ETPs from the pilot for several reasons.

First, the pilot will likely have anticompetitive effects among issuers. ETPs should trade in a consistent market structure. Unlike the stocks of competing operating companies that differ based on company fundamentals, competing ETPs can provide investors with exposures that are similar, if not identical, to each other. When investors evaluate similar ETPs in their decision-making, the bid-ask spread is often included in calculating the total cost of ownership. An investor who has made an investment decision based on liquidity factors may later discover that the total cost of ownership has changed because of a pilot program run by the government. This could erode investor confidence in the equity markets and also raises the question of whether ETP issuers would be expected to disclose any impacts of the pilot to investors.

Second, if the pilot results in bid-ask spreads widening, it will likely result in spreads widening for ETPs holding pilot stocks, even if ETPs are not included in the pilot, given that fair value calculations rely on underlying constituent pricing. If the pilot includes ETPs and many of their underlying securities, we are concerned that any negative effects of the pilot on transaction costs could be intensified for ETP investors. This could harm investor experience and over-complicate the analysis of the pilot.

Third, we believe that the goals of the pilot can be achieved without having to include ETPs in the pilot. The effects of the pilot on stocks will be sufficient to draw conclusions about potential changes to access fee rules.

[8] For our comments on the SEC's Proposed Order Handling Disclosure Rule (September 26, 2016), see https://www.sec.gov/comments/s7-14-16/s71416-24.pdf.

[9] See Supra note 2.

If the Commission determines to include ETPs in the pilot, the following approaches could help mitigate, but would not eliminate, the concerns discussed above: (1) ensure ETPs tracking the same index and/or with similar underlying basket holdings are assigned to the same test group; or (2) rotate the entire universe of ETPs through each test group sequentially. For example, place all ETPs in Test Group 1 for a predetermined period, then Test Group 2, 3, and the Control Group in subsequent periods.

Include Early Termination Criteria for the Pilot

The Commission proposed a two-year term for the pilot, with an automatic sunset at the end of the first year, unless the Commission determines that the pilot should continue for the second year. The Commission should provide more assurance that if the pilot increases costs for investors, the impact would be mitigated.

We suggest modifying the proposal to include key elements from the EMSAC's recommendation. First, begin with a more limited set of stocks for an initial three-month measurement period, before expanding to the full set of pilot stocks (e.g., start with ten stocks in each bucket before expanding to 100). Second, ensure ongoing monitoring to potentially terminate the program early should there be significant deterioration in any of the measurement criteria. Accordingly, the Commission should specify the conditions under which it would determine to end the pilot early.

Conclusion

We commend the Commission's efforts to improve equity market structure by evaluating the effects of reducing access fees and rebates. We believe the pilot should generate valuable data. We recommend modifying the proposal in ways that mitigate the risk of potential adverse effects of the pilot for investors, which could be particularly acute in the no-rebate test group. We suggest: defining measurement criteria; reducing the size of the pilot; excluding ETPs from the pilot; and including an early termination clause, with the goal of ensuring that success is based on market quality and the investor experience. If ETPs are included in the pilot, we recommend careful consideration of the test groups and consideration of rotating the entire universe of ETPs through each test group sequentially. Finally, we urge the Commission to move forward with final rules on order routing transparency.

We would be pleased to elaborate on our comments in discussions with the Commission and the Staff. If you have any questions, please do not hesitate to contact us.

Sincerely,

Timothy J. Coyne
Global Head of ETF Capital Markets

Nathaniel N. Evarts
Head of Trading, Americas

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
Brett Redfearn, Director, Division of Trading and Markets