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May 25, 2018

Submitted electronically

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

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

Dear Mr. Fields:

Vanguard¹ appreciates the opportunity to provide comments to the Securities and Exchange Commission (“SEC”) on the Transaction Fee Pilot for NMS Stocks (the “Pilot”). Vanguard commends the effort of the SEC, and the perspectives provided by the Equity Market Structure Advisory Committee, to gain insight into how exchange fees and rebates impact market quality and participant behavior, specifically as it relates to order routing and transparency. As discussed in detail below, and consistent with prior comments, Vanguard strongly supports the Pilot and its goals.²

Vanguard applauds the Pilot as an appropriate next step to improve the robust U.S. equity markets for investors. In particular, we support the Pilot’s focus on whether transaction fees promote conflicts of interest by incentivizing trading designed to capitalize on capturing rebates

¹ Vanguard is an SEC-registered investment adviser to more than 200 funds, including 56 exchange traded funds listed in the United States, with aggregate assets of approximately \$4.6 trillion. Vanguard also offers retail brokerage services to its clients through Vanguard Brokerage Services. Vanguard’s comment reflects a collective view of the equity markets.

² See, e.g., SEC Equity Market Structure Advisory Committee Meeting, October 27, 2015 (statement of Michael Buek, as Principal and Portfolio Manager, Vanguard), *available at* <https://www.sec.gov/comments/265-29/26529-44.pdf>; Letter from Mortimer J. Buckley, as Managing Director and Chief Investment Officer, Vanguard, dated December 19, 2014, *available at* <https://www.sec.gov/comments/4-657/4657-57.pdf>; Senate Permanent Subcommittee on Investigations hearing on “Conflicts of Interest, Investor Loss of Confidence, and High Speed Trading in U.S. Stock Markets”, June 17, 2014 (written testimony of Joseph Brennan, as Principal and Head of Global Equity Index Group, Vanguard), *available at* [https://www.hsgac.senate.gov/imo/media/doc/STMT%20-%20Brennan%20-%20Vanguard%20\(June%2017%202014\).pdf](https://www.hsgac.senate.gov/imo/media/doc/STMT%20-%20Brennan%20-%20Vanguard%20(June%2017%202014).pdf).

and avoiding fees. The “maker-taker” model was created for the important purpose of attracting liquidity to public markets and promoting price discovery. However, over time, as exchanges implemented different iterations of the model, fees and rebates became increasingly important aspects of trading dynamics. Similarly, the desire to maximize rebate revenue and avoid fees created order complexity within the equity markets as traders sought profitable trading strategies. Finally, because fees and rebates differ across exchanges, the model creates the appearance of a conflict between broker-dealers and their customers, as firms may appear motivated to route an order to a specific exchange to realize a higher rebate or a lower fee. As a result, Vanguard strongly supports the Pilot, which will enable the SEC to assess the impacts of the maker-taker model on order routing practices, transparency, and price discovery.

I. The Pilot’s structure enables the SEC to assess permanent changes to the model.

a. The Pilot should include all NMS stocks and Exchange-Traded Products (“ETPs”).

Vanguard generally supports the structure and design of the Pilot as described in the release. We believe it will provide the SEC with meaningful data to improve equity market structure. The Pilot is consistent with Vanguard’s prior comments that it should include stocks with various levels of liquidity. By including all NMS stocks, the SEC will receive data to analyze the impacts of transaction fees on market quality across various types of securities.

Vanguard is also supportive of the inclusion of ETPs in the Pilot. We recognize that certain industry participants have argued that the Pilot could create a competitive disadvantage for an ETP in one fee cap bucket relative to other ETPs tracking the same index but in a different fee cap bucket. Although it is possible the Pilot may create a minimal temporary competitive disadvantage for like-products in the less-than-optimal buckets, we anticipate this will not have a significant impact on investor behavior. Additionally, we believe the benefits from collecting data that informs long-term market structure improvements will outweigh any potential temporary disadvantage. If the SEC finds that developing a method to place such products in the same bucket is overly complex or could delay implementation then we support moving forward as proposed for the short duration of the Pilot.

b. The Pilot should include inverse exchanges.

Vanguard supports the inclusion of taker-maker exchanges, which pay rebates to take liquidity and charge a fee to provide liquidity, in the Pilot. This will allow the SEC to gather data on all equities exchange transaction fees and broadly analyze potential conflicts created by transaction fees generally rather than simply one fee structure.

c. The Pilot should include a no-rebate bucket.

Vanguard strongly supports the inclusion of a no-rebate bucket in the Pilot. Vanguard agrees that the data collected in the Pilot will be substantially more informative with a no-rebate bucket than a pilot without one. Removing the incentive of transaction fees and the

corresponding rebate charges permits direct observation regarding the impact of rebates on order routing behavior and execution quality, as well as market quality. We anticipate that comparing data from the no-rebate bucket to the other Pilot results will highlight inefficiencies in the current transaction fee model.

d. The SEC’s analysis should include diverse data points.

Vanguard believes the SEC should carefully consider the data points used to measure market quality and potential conflicts of interest. We agree with the SEC that bid-ask spread is one appropriate metric, but also think the analysis should examine other data points. For example, while an analysis of the impact on bid-ask spread will be helpful, we believe the SEC should also analyze the impact on execution quality (e.g., effective spread). Further, we believe the analysis should examine data on order routing decisions, certainty of execution, time to execution, depth of book, quote volatility, and market impact on larger trades.

II. The Pilot’s duration should be no longer than necessary to collect meaningful data.

Vanguard believes meaningful data that allows the SEC to analyze the appropriateness of a permanent rule change can be collected quickly and with relative ease.³ For example, implementing the Pilot as described in the release will not require significant resources because technology already exists to change how fees and rebates are applied. Vanguard agrees with the general concept of the timing of the Pilot, which includes an automatic sunset provision after one year unless the SEC publishes a notice that the Pilot shall continue for up to an additional year. Further, Vanguard thinks the SEC should have the ability to end the Pilot earlier than one year under two scenarios. The first scenario is if the Pilot produces a robust statistical sample set earlier than a year, such that the SEC can end the Pilot and proceed to adopt permanent rule changes. The second scenario is if there is unintended impact from the Pilot that warrants a stoppage. Such discretion will not deter from the goals of the Pilot while providing a mechanism that could help further broader improvement in the equity markets.

III. The SEC should use data from the Pilot to inform broader equity market structure improvements.

Vanguard has long supported a review of “trade-at” and the incentives to publicly display liquidity.⁴ At this time, however, we support the Pilot moving forward without a trade-at component because we recognize that a pilot focused on rebates and fees can be implemented quickly with less regulatory change and, therefore, expedite the collection of meaningful data for use in broader regulatory reform under Regulation NMS. We continue to support broader

³ The release notes that the Pilot and the existing Tick Size Pilot may overlap. Vanguard believes the SEC has obtained the information necessary from the Tick Size Pilot. Investors and the markets will be best served by ending the Tick Size Pilot and avoiding increased complexity in the design of the Pilot.

⁴ See Letter from Mortimer J. Buckley, as Managing Director and Chief Investment Officer, Vanguard, dated December 19, 2014, available at <https://www.sec.gov/comments/4-657/4657-57.pdf>.

regulatory improvements informed by that data, including undertaking a review of trade-at as we believe a trade-at rule would incentivize the public display of trading interest, contribute to the price discovery process, and decrease the overall complexity of the equity markets.

We appreciate the opportunity to comment on the Pilot. If you have any questions about Vanguard's comments or would like any additional information, please contact Christyn Rossman, Senior Counsel, at [REDACTED] or Josh Dutill, Associate Counsel, at [REDACTED].

Sincerely,

/s/ Joseph Brennan

Joseph Brennan
Principal and Global Head of Equity Investment Group
Vanguard

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