May 25, 2018

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

Re: **Proposed Rule on Transaction Fee Pilot for NMS Stocks**

Dear Mr. Fields:

Charles Schwab & Co., Inc. ("Schwab")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's ("Commission") recently proposed rule for a Transaction Fee Pilot for National Market System ("NMS") stocks. While the current market structure serves our retail customers very well, providing them with narrow spreads, abundant liquidity and frequent opportunities for price improvement on their orders, we continue to support efforts by the Commission to use data-driven methodologies to explore ways to make our equity market structure work even better for the retail investor. Indeed, in our comment letter on the then-proposed tick-size pilot in December 2014, we advocated that the Commission undertake a test of how reducing access fees and rebates might impact order-routing behavior.[2]

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[1] Charles Schwab & Co., Inc. (member SIPC), is the broker-dealer affiliate of The Charles Schwab Corporation (NYSE: SCHW), a leading provider of financial services, with more than 345 offices and 11.0 million active brokerage accounts, 1.6 million corporate retirement plan participants, 1.2 million banking accounts, and $3.31 trillion in client assets as of March 31, 2018. Through its operating subsidiaries, the company provides a full range of wealth management, securities brokerage, banking, money management, custody, and financial advisory services to individual investors and independent investment advisors. Its broker-dealer subsidiary and affiliates offer a complete range of investment services and products including an extensive selection of mutual funds; financial planning and investment advice; retirement plan and equity compensation plan services; referrals to independent fee-based investment advisors; and custodial, operational and trading support for independent, fee-based investment advisors through Schwab Advisor Services. Its banking subsidiary, Charles Schwab Bank (member FDIC and an Equal Housing Lender), provides banking and lending services and products. More information is available at www.schwab.com and www.aboutschwab.com.

[2] Charles Schwab & Co. comment letter on National Market System plan to implement a Tick Size pilot program: https://www.sec.gov/comments/4-657/4657-79.pdf

Appropriate Execution Quality Metrics Must be Employed and Published

Given the overall positive experience that retail investors enjoy in the current equity marketplace, Schwab's primary concern with the pilot is ensuring it is analyzed using appropriate metrics. Before any changes are proposed as a result of the pilot, the pilot's data must be defined and quantified to determine how such changes might impact quoted spread, depth of liquidity, intraday stock volatility, and opportunities for price improvement on impacted securities. Where the data suggest clear harm to the retail investor in these and other relevant execution quality metrics, the transaction fee pilot should be immediately suspended.

Pilot Structure

A significant concern we have with the proposed pilot is its outsized scope. Including 1,000 different NMS stocks in each of the three Test Groups seems to be many more than necessary to gather the requisite data to test the various access fee/rebate levels. In addition to the administrative costs associated with applying the pilot to so many stocks, we also have concerns that if the pilot ends up negatively impacting the quoted spread, liquidity and/or other trade execution quality metrics, then our retail clients will be much more broadly impacted in a negative way because of the pilot's large scope. We are much more supportive of the scope put forward by the Equity Market Structure Advisory Committee ("EMSAC")[3] in its pilot proposal. EMSAC called for three test buckets with 100 securities in each bucket.

We appreciate and want to underscore our support for the Commission's decision to not include options within the scope of the pilot. As the Commission outlines in the Pilot proposal, the fee cap under Rule 610(c), on which the proposed Pilot is largely based, does not apply to options exchanges, and equities and options have very different market structures. The options market is quote-driven and has no trade reporting facility to allow for off-exchange trading. In addition, options employ multiple trade allocation methodologies that would further complicate any effort to include them within the scope of the Pilot.

Furthermore, the pilot should not include a "trade-at" provision. While some have argued that so-called "fragmentation" of the marketplace has a negative impact on the overall quality of our equity markets, Schwab takes a different view. We believe that competition amongst trade execution venues fostered by the current market structure rule set has had a profoundly positive impact on the execution of our retail customers' orders. The trade-at provision would shift execution market share to exchanges by regulatory fiat, not by the result of free and fair competition. Including a trade-at provision would negatively impact the superior order execution quality that our retail customers currently enjoy. A trade-at provision would also unnecessarily add to the pilot's complexity and implementation costs, while making it more difficult to analyze.

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[3] U.S. Securities & Exchange Commission, Equity Market Structure Advisory Committee, "Recommendation for an Access Fee Pilot": https://www.sec.gov/spotlight/emsac/recommendation-access-fee-pilot.pdf

Similarly, while there has been some discussion about potentially expanding the pilot to eliminate Regulation NMS Rule 611 protected quotation status in one or more Test Groups, we again have baseline concerns that doing so would significantly negatively impact retail order flow and the quality of trade execution for our clients, which in turn would foster retail investor distrust in our markets. Including such provisions in this pilot, in particular, would overly complicate the pilot and make it even more difficult to isolate and analyze findings related to reducing transaction fees and rebates.

An additional area of concern with the proposed pilot's structure that we want to raise on behalf of our affiliate, Charles Schwab Investment Management (CSIM), is how ETFs will be handled under the pilot. While each individual stock is unique, many ETFs, in particular index-based ETFs, are quite similar. The investment profile can be nearly identical in many cases, and the differences may be confined to expense ratio, subtle variations in tracking error, and perceived or real differences in secondary market liquidity. As a leading provider of index ETFs, CSIM is concerned that including similar ETFs in different buckets of the pilot through a stratified sampling technique may have irreversible negative competitive consequences for certain ETFs. For example, as proposed, the pilot does not address the role and compensation structure for a Lead Market Maker or Designated Liquidity Provider ("LMM" or "DLP"). The inclusion of a Test Group that prohibits rebates entirely, however, suggests that this critical role may not exist for ETFs included in this Test Group. The absence of an LMM or DLP could be problematic for ETFs that have not already reached critical mass in terms of daily secondary market turnover.

We are aware of several different potential remedies for these concerns. Although, candidly, we are uncertain as to how effective any of these remedies will be in addressing them. Some ideas that have been discussed include: allowing ETFs to opt-out of the pilot if inclusion in the pilot has demonstrable negative competitive consequences; putting all similar ETFs into the same bucket, and; rotating ETFs throughout the different buckets periodically. If none of these potential remedies are seen as acceptable alternatives to what has been proposed in the pilot, we would encourage the Commission to also seriously consider not including ETFs in the pilot at all, given how they differ fundamentally from individual stocks in certain key ways.

At this time, Schwab is not clear on whether any of the proposed remedies would address these concerns effectively or fairly. As such, we believe the Commission should carefully consider how ETFs should be handled within the pilot (and if they should be included at all), given the very real concerns that we share with others as to how the pilot could negatively impact the overall competitive landscape for these investment vehicles and ultimately lead to fewer choices for end investors.

No Overlap with Tick Size Pilot

Finally, in regards to the timing of the transaction fee pilot, Schwab strongly recommends that it not overlap with the ongoing Tick Size Pilot. In our view, one major pilot analyzing different aspects of potential changes to our equity market structure at any given time is enough. With two pilots operating at the same time, different operational challenges are introduced, while the ability to analyze the results from either of the pilots is complicated. Having the two pilots overlap, however, should not be an issue, as it is our view that the Commission should already have plenty of data to analyze from the Tick Size Pilot. We believe the Tick Size Pilot should be ended soon, certainly by the time it is scheduled to end in October 2018, as it has already outlived any potential usefulness. The data we have already seen from that pilot seems to support our initial view[4] that we expressed when it was proposed. Namely, that by mandating wider spreads, it would negatively impact retail investors, with little to show on the positive side.

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Once again, Schwab has supported for some time efforts to analyze how altering the current transaction fee and rebate structure for NMS stocks might impact and perhaps improve trade execution quality for our retail customers. We appreciate the Commission's efforts to undertake a pilot in this area.

Thank you for providing this opportunity to comment on the recently proposed Transaction Fee Pilot for NMS stocks. As always, we stand ready to provide additional input on the issues we raise in this letter, as well as any other items, either in person or over the phone, if members of the Commission or its staff are interested in further discussion with us. If that is the case, please contact Schwab's Office of Legislative and Regulatory Affairs at [redacted]. Thank you very much for your consideration of our views on these matters.

Sincerely,

Jason Clague
Executive Vice President
Operational Services

cc: The Honorable Jay Clayton
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar
The Honorable Robert J. Jackson Jr.
The Honorable Hester M. Peirce

Brett Redfearn, Director
Division of Trading and Markets

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[4] Charles Schwab & Co. comment letter on National Market System plan to implement a Tick Size pilot program: https://www.sec.gov/comments/4-657/4657-79.pdf