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May 25, 2018

Brent J. Fields, Esq.
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-0609

**Re: File No. S7-05-18 – Transaction Fee Pilot for NMS Stocks**

Dear Mr. Fields:

MFS Investment Management ("MFS")[1] appreciates the opportunity to comment on the proposal by the Securities and Exchange Commission ("SEC" or "Commission") to conduct a Transaction Fee Pilot for National Market System ("NMS") stocks to study the effects that transaction-based fees and rebates may have on, and the effects that changes to those fees and rebates may have on, order routing behavior, execution quality, and market quality more generally ("Pilot"). MFS strongly supports the proposed Pilot. In this regard, we support the observations and recommendations regarding the proposed Pilot set forth in the comment letter, dated May 23, 2018, filed by the Investment Company Institute with the Commission. MFS does not anticipate that the proposed Pilot would negatively affect liquidity, which we value in our investment process. In addition, we write separately to address specific areas of concern to MFS.

As the release proposing the Pilot[2] ("Proposal") notes, while Regulation NMS, adopted in 2005, has played a significant role in shaping today's equity market structure, subsequent events have caused market practices to continue to evolve. In addition, we have been able to observe the impact of events such as demutualization and fragmentation, which had already begun to occur at the time that Regulation NMS was adopted but the consequences of which were still unclear at the time. It is with the benefit of the knowledge that we have gleaned that we comment on four specific aspects of the current equity market structure which we believe will have an impact upon the quality of the data generated by the Pilot:

**1. Inclusion of Alternative Trading Systems**

The Proposal discusses Alternative Trading Systems ("ATSs") in detail and specifically asks:

> Should the proposed Pilot be expanded to include ATSs? Why or why not? What would be the anticipated impact of including ATSs in the proposed Pilot? If the proposed Pilot were expanded to include ATSs, should all ATSs be included or only certain ATSs? What, if any, are the potential competitive impacts of excluding ATSs from the proposed Pilot? Would including ATSs in the proposed Pilot have any likely effect on ATS business models? To what extent do ATSs charge fees that are not transaction-based? If the proposed Pilot includes ATSs, how should it apply to ATS fees that are not transaction-based? Also, to apply the proposed Pilot to ATSs,

[1] MFS Investment Management traces its history to 1924 and the creation of the country's first mutual fund, Massachusetts Investors Trust. Today MFS is a global investment manager managing approximately $478 billion in assets through a variety of collective investment vehicles and separate accounts.

[2] *Transaction Fee Pilot for NMS Stocks*, Securities Exchange Act Rel. No. 82873 (Mar. 14, 2018). 83 FR 13008 (Mar. 26, 2018).

> would the Commission need to impose other new requirements on ATSs, such as fee disclosure requirements? If ATSs were to be included in the proposed Pilot, would they be able to collect and report the proposed data 94 or would changes be necessary to accommodate ATSs?[3]

MFS believes that if an ATS charges or rebates transaction-based fees, it should be included in the Pilot. We are concerned that if such an ATS is excluded from the Pilot, brokers may have an incentive to route orders to it – particularly for as long as the Order Routing Disclosure amendments remain unadopted. By the same token, if an ATS does not charge or rebate transaction-based fees, we do not see a need to include it in the Pilot – we do not believe that the information generated would be of more than minimal value.

2. **Measuring the Efficacy of the Pilot**

In order to assess the efficacy of the Pilot, MFS proposes that the SEC focus on three specific measures: the market-wide daily Herfindahl-Hirschman Index ("HHI"), the Effective-to-Quoted Spread Ratio, and the Implicit Execution Cost.

The HHI, which was recently featured in a recent Commission staff memorandum,[4] is an effective measure of market concentration which can be used to determine whether a Test Group promotes exchange consolidation or fragmentation. MFS believes that an increase in the measured index level suggesting more fragmentation amongst exchanges should be considered a failed outcome for the Pilot as more fragmentation is a proxy for more opportunities for conflicts of interest in routing.

However, should the measured HHI level decline, the SEC should subsequently assess measures of execution quality to ensure that there is no significant deterioration accompanying the reduction in fragmentation. In order to assess execution quality for the retail market, MFS suggests the committee focus on the effective to quoted spread ratio, which measures the level of price improvement received on an execution. For institutional order flow, MFS recommends focusing on the Implicit Execution Cost for orders,[5] which accounts for the level of price movement involved in completing an institutional order.

In assessing these metrics, MFS would consider a Pilot Test Group unsuccessful if the Test Group's HHI declined but both the effective/quoted ratio and the average market impact cost did not remain constant (or decline). Importantly, if one of the execution quality metrics improves while the other deteriorates, this should not be seen as a failure but instead should be viewed as evidence of one part of the market subsidizing the other under the current regime. Finally, as the SEC has done for the tick pilot program, it may be prudent to nominate a third party firm experienced in transaction cost analysis that has access to the necessary data to perform the analysis.

3. **Test Group 3 – Scope of Prohibition**

MFS strongly supports the inclusion of Test Group 3 in the Pilot and agrees that rebates and linked pricing on Test Group 3 securities offering a discount or incentive on transaction fee pricing applicable to removing (providing) liquidity that is linked to providing (removing) liquidity (so-called "linked pricing"). MFS strongly supports this prohibition. However, MFS believes that the scope of the prohibition should

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[3] *Id.*, 83 FR at 13016.

[4] *Empirical Analysis of Liquidity Demographics and Market Quality For Thinly-Traded NMS Stocks*, Office of Analytics and Research, Division of Trading and Markets, SEC (April 10, 2018) (https://www.sec.gov/files/thinly_traded_eqs_data_summary.pdf).

[5] This methodology is outlined in *TCA Best Practices for Equities*, FIX Trading Community (Jan. 21, 2014), at p. 10 (https://www.fixtrading.org/packages/tca-best-practices-for-equities/).

extend to all forms of inducements that an exchange may otherwise offer. For example, it is not clear to MFS that offering a discount on market data otherwise consumed in exchange for providing liquidity would run afoul of the prohibition. We believe that the SEC should make clear that absolutely no form of inducement – whether market data, co-location, ports or other exchange fees – is permissible with respect to securities in Test Group 3.

4. **Issuer Opt-Outs**

The Proposal asks:

> Should issuers be allowed to opt-out of the proposed Pilot or would allowing issuers to opt out adversely affect the proposed Pilot? If so, how? What would be the impact on the extent and quality of the data?[6]

MFS strongly believes that issuers should not be allowed to opt-out. We believe that if issuers are allowed to opt out, there would be no way to assure a stratified sample that would replicate the data that would be generated if all issuers were included the proposed Pilot. We also believe that allowing issuers to do so may set an unfortunate precedent that would allow an issuer to pick and choose among those aspects of the National Market System that it likes while rejecting other aspects that it may find less attractive to it, but are necessary to the smooth functioning of United States public equity markets.

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We appreciate the opportunity to comment on the Proposal. If you have any questions regarding this comment letter or need additional information, please contact me at [redacted], Jeffrey Estella at [redacted] or Brenda Farley at [redacted].

Sincerely,

Heidi W. Hardin
General Counsel

cc: The Honorable Walter J. Clayton
Chairman
Securities and Exchange Commission

The Honorable Kara M. Stein
Commissioner
Securities and Exchange Commission

The Honorable Michael S. Piwowar
Commissioner
Securities and Exchange Commission

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[6] *Proposal, supra* note 2, 83 FR at 13019.

The Honorable Robert J. Jackson, Jr.
Commissioner
Securities and Exchange Commission

The Honorable Hester M. Peirce
Commissioner
Securities and Exchange Commission