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May 30, 2018

Brent J. Fields  
Secretary  
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:

We appreciate the opportunity to comment on the Securities and Exchange Commission's (the "Commission") above-referenced proposal to conduct a pilot program to assess how exchange transaction fees and rebates affect market quality for national market system ("NMS") stocks (the "Pilot"). The Capital Group Companies ("Capital Group") is a global asset management firm with offices in Europe, Asia and the Americas. Through our investment management subsidiaries, we actively manage assets in various collective investment vehicles and institutional client separate accounts globally. The vast majority of these assets consist of the American Funds family of mutual funds, which are U.S. regulated investment companies distributed through financial intermediaries and held by individuals and institutions across different types of accounts.

We would first like to commend the Commission on its efforts to evaluate and improve equity trade execution and market quality for investors. Capital Group has been a strong advocate for equity market structure improvements, including the study of the impact that rebates have on the microstructure of equity markets.<sup>1</sup> We strongly support the

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<sup>1</sup> Statement of Matt Lyons, Senior Vice President and Global Trading Manager of The Capital Group, before the U.S. House of Representatives Committee on Financial Services on U.S. Equity Market Structure: A Review of the Evolution of Today's Equity Market Structure and How We Got Here (June 27, 2017), available at <https://financialservices.house.gov/uploadedfiles/hrg-115-ba16-wstate-mlyons-20170627.pdf>; EMSAC - Presentation on Maker Taker Pricing, Matt Lyons (October 27, 2015), available at <https://www.sec.gov/spotlight/capital-group-presentation-matt-lyons-emsac.pdf>; and Letter from Timothy D. Armour, Chairman of The Capital Group Companies, to Brent J. Fields,

Commission's proposal to conduct the Pilot to assess how transaction-based fees and rebates affect order routing behavior, execution quality and market quality for NMS stocks. We believe that the analysis of the Pilot results will lead to more focused discussions on the desirable changes to the existing regulatory regime. However, we also believe that some minor modifications will help to more effectively and comprehensively achieve the objective of the Pilot.

Over the past few decades, the securities market structure has evolved as a result of technological innovations and the Commission's rulemaking, including Rule 601(c) under Regulation NMS, which was adopted to encourage market competition and lower execution costs for the benefit of investors. While largely successful, we believe one of the unintended consequences of the financial evolution was the emergence of the "maker-taker" fee model where an exchange pays a liquidity provider a per-share rebate and charges a liquidity taker a per-share access fee.

The "maker-taker" model, as well as the inverted, "taker-maker" model, have become a growing concern for investors because the pricing scheme impacts broker-dealers' order routing practices. These pricing models present broker-dealers with a potential conflict of interest. A broker-dealers' duty to pursue best execution could be compromised when their trading venue decision is driven by the economic incentive to minimize access fees paid and maximize rebates received. To maximize their profit in executing customers' orders, broker-dealers are incentivized to route orders to non-exchange trading centers to avoid the higher access fees that exchanges charge to subsidize the rebates they offer. This order routing practice has resulted in the proliferation of Alternative Trading Systems ("ATs") in the market. Our internal trade analysis suggests that execution quality may be negatively impacted when broker-dealers' routing decisions are made to minimize access fees. Moreover, the market has seen numerous cases of inadequate disclosures and improper arrangements made between market makers and ATs that may disadvantage institutional clients.<sup>2</sup>

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Secretary, Commission (September 29, 2015), available at <https://www.sec.gov/comments/10-222/10222-2.pdf>.

<sup>2</sup> See, e.g., "Barclays, Credit Suisse Charged with Dark Pool Violations," Press Release, Commission (January 31, 2016), available at <https://www.sec.gov/news/pressrelease/2016-16.html>; "A.G. Schneiderman Announces Landmark Resolutions with Barclays and Credit Suisse for Fraudulent Operation of Dark Pools; Combined Penalties and Disgorgement to State of New York and SEC over \$154 Million," Press Release, New York State Office of the Attorney General (February 1, 2016), available at <https://ag.ny.gov/press-release/ag-schneiderman-announces-landmark-resolutions-barclays-and-credit-suisse-fraudulent>; "SEC Charges ITG with Operating Secret Trading Desk and Misusing Dark Pool Subscriber Trading Information," Press Release, Commission (August 12, 2015), available at <https://www.sec.gov/news/pressrelease/2015-164.html>; Stanislav Dolgoplov, "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, 249 (2014), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2399821](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2399821); 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), available at <http://onlinelibrary.wiley.com/doi/10.1111/jofi.12422/full>; and James Angel, Lawrence Harris & Chester Spatt, "Equity Trading in the 21<sup>st</sup> Century," Quarterly Journal of Finance 1 (2011), available at <https://doi.org/10.1142/S2010139211000067>.

Other unintended consequences of the market evolution include information leakage and the distortion of price discovery process. Like all investment activities, market-making is a risk-reward tradeoff. Historically, the compensation for taking the risk of making a market was the spread between the bid and the offer. However, rebates paid to liquidity providers in the maker-taker fee scheme effectively offers a subsidy to market makers who may encounter adverse selection. The rebate subsidy reduces the risk associated with making markets and allows market makers to develop strategies to determine imbalances in supply and demand, which, in turn, will inform their future decisions on providing or taking liquidity. For example, we believe entering and cancelling orders in milliseconds distorts the true supply and demand price discovery process.

In light of the above, we strongly support the Pilot and offer the following comments on specific aspects of the Pilot.

### **Applicable Trading Centers**

We agree with the Commission's assessment that the Pilot should apply to all equity exchanges, including the inverted, "taker-maker" model, thus treating all similarly situated exchanges equally. This is critically important in determining what impact the reduction of access fees or the elimination of rebates will have on order routing practices. However, as discussed above, we believe that lowering the access fee caps in the Pilot will effectively limit the rebates paid by trade centers to attract liquidity, which could undermine the competitiveness of exchanges relative to ATSs. While we agree with the Commission's assessment that including ATSs in the Pilot may not be practicable and expose the Pilot to unwarranted complexities, we strongly encourage the Commission to consider including ATSs in Test Group 3 so that the "no-rebate" limits are applied to ATSs. This would allow ATSs to continue their operation without being subject to new reporting obligations while leveling the playing field for all trading centers. If ATSs are excluded from Test Group 3, as currently proposed by the Commission, we believe that the Pilot may increase the order flow into ATSs as broker-dealers may be incentivized to route orders to ATSs in order to receive the rebates available at these venues.

### **Pilot Design**

We support the overall pilot design as proposed and commend the Commission's decision to include in the program Test Group 3 which prohibits rebates and linked pricing incentives. As discussed above, we believe rebates funded by access fees have created a conflict of interest for broker-dealers in their routing practices. Though we are aware that other market participants have argued that a reduction in access fees would achieve the objective of the Pilot, we strongly believe that the "no-rebate" Test Group 3 will generate data about how market quality changes in the absence of rebates. Without Test Group 3, exchanges may still manage to create pricing structure that subsidizes liquidity providers or takers, obfuscating the market data the Commission seeks to analyze.

## Data Analysis

We support the elements of data that the Commission proposes to collect through the Pilot. However, we urge the Commission to provide additional detail on how the Commission intends to analyze the data and assess the impact of access fees and rebates on market quality. Further, we strongly encourage the Commission to articulate how it plans to measure the success of the Pilot. If helpful, Capital Group would be glad to participate in efforts to identify the metrics for measuring the impact on market quality, including routing patterns, distribution of order flow among venues and quote spreads, as well as the success criteria.

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We truly appreciate the opportunity to comment on the Pilot and applaud the ongoing work of the Commission and its continuing efforts to provide a fair, transparent, and well regulated marketplace. If you have any questions regarding our comments, please feel free to contact Matt Lyons at [REDACTED].

Sincerely,

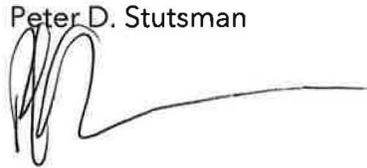
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cc: The Honorable Jay Clayton, Chair  
The Honorable Kara M. Stein, Commissioner  
The Honorable Michael S. Piwowar, Commissioner  
The Honorable Robert J. Jackson Jr. Commissioner  
The Honorable Hester M. Peirce, Commissioner

Brett Redfearn, Director, Division of Trading and Markets  
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