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July 2, 2018

By Electronic Mail

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Transaction Fee Pilot; Securities Exchange Act Release No. 82873; File No. S7-05-18

Dear Mr. Fields,

ViableMkts appreciates the opportunity to comment on the proposed Transaction Fee Pilot for NMS Stocks to point out a major flaw in the timing and design of the proposal that will subvert its intended result.

Recommendation:

ViableMkts believes that the SEC should postpone the pilot until a reasonable baseline of data can be collected. Specifically, the SEC should implement an enhanced version of the proposal to modify rule 606[1] along the lines that I have previously articulated[2]. If there was data that measures the choices that brokers make when routing and the effectiveness of those choices, that could be used to establish a baseline of behaviour to evaluate vis a vis the various rebate and fee buckets that the pilot establishes. Without such a baseline, or even the collection of routing data, the pilot is guaranteed to fail in its avowed goal "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"[3].

Rationale for the Recommendations:

In order to be considered a success, this pilot would need to have statistically significant results that demonstrate both behavioural changes of routing brokers and clearly articulated differences in the execution quality achieved by routing agents. In addition, both would need to be isolated to differences in fee or rebate levels. Such a result requires that the pilot have an appropriate baseline of data to compare both the control and test groups in order to rule out other market related factors. Unfortunately, there is no such data available today, which means that, at a minimum, the pilot needs to be delayed while such data could be gathered. Unfortunately, flaws in the data collection in the pilot itself would make this impossible. Specifically, there are two fundamental flaws: a lack of routing data from the perspective of routing brokers and an exclusion of many routing choices.

[1] Release No. 34-78309; File No. S7-14-16 https://www.sec.gov/rules/proposed/2016/34-78309.pdf
[2] https://www.sec.gov/comments/s7-14-16/s71416-13.pdf & https://www.sec.gov/comments/s7-14-16/s71416-1556280-131464.pdf
[3] [Release No. 34-82873; File No. S7-05-18] https://www.sec.gov/rules/proposed/2018/34-82873.pdf

The pilot does not collect data from the perspective of routing brokers, therefore losing the ability to evaluate either the choices made by brokers or the effectiveness of those choices.

The pilot relies upon market centers to provide data on routing choices, but, in doing so, obscures the context of many choices. Only the routing broker knows if an order was placed based on an algorithmic choice or due to client instructions. Moreover, only the routing broker knows if an order was placed as part of a package of orders, individually, or as part of a sequence. All of these can create differences that will only show up as part of an analysis of the routing broker, rather than from the perspective of the exchange or market the order was routed to. This is a complex topic, which I have covered in numerous commentaries over the years[4], but the core point is clear. Without routing data, the pilot can't be judged.

The pilot excludes data on a wide array of routing choices, including broker to broker routing, routing to Alternative Trading Systems or single dealer platforms, market makers, and responses to Indications of Interest (IOIs).

Whether or not one believes that Alternative Trading Systems (ATSs), single dealer platforms, market makers or agent brokers that receive routed orders should be part of the pilots fee restrictions, they must be included in the data. All of these destinations are part of the routing choices made by agent brokers and can materially impact the execution quality received by clients. As a result, without collecting data on such venues, particularly in the context in which they are used, makes it impossible to know if transactions-based fees and rebates result in broker routing choices that are detrimental to their clients. The results achieved on exchanges can be materially impacted by how the orders were sent, particularly if the timestamps are only at the millisecond level of granularity. Orders sent sequentially or after similar orders had previously been sent to ATSs are less likely to execute, and there is no way that the receiving exchange can know or report on such circumstances. In short, the exclusion of over 35% of all trading data is a serious flaw in the proposed pilot.

In conclusion, the pilot lacks the data to analyse orders from statistically comparable categories, in the proper perspective. Without analysing the decisions of individual brokers and comparing the execution quality and fill rates on comparable orders sent to rebate paying and non-rebate paying or high cost vs low cost venues, there is no way to determine if changing the allowed fees has any impact on the conflicts of interest that the pilot is meant to study. Thus, the Commission should either postpone this pilot until after Rule 606 is appropriately modified, or change the pilot dramatically to include collecting routing data from brokers for a baseline period before proceeding with fee changes.

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I would like to thank the Commission for the opportunity to submit these comments. If the Commission has any questions or would like additional information, please do not hesitate to contact me.

Respectfully submitted,

[4] https://www.marketsmedia.com/can-now-by-david-weisberger-ihs-markit/, http://www.viablemkts.com/never-mind-not-droids-orders-looking/

David M. Weisberger
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[redacted]