# Issuer Network

***Corporate America's Leading Issuer Advocate And Market Expert***

Via Email

December 14, 2018

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. Secretary:

We write to you today regarding your proposed Transaction Fee Pilot for NMS Stocks as well as numerous concomitant concerns. Our comments, as presented in the following "Issuer Update – *the Fairness War*", reflect the views of numerous issuers with whom we have had substantial conversations.

Based upon these discussions the overwhelming consensus of the Issuer Community is that <u>the AFP is a very BAD IDEA!</u> <u>Not only does it pit issuers against one another via differing liquidity incentives, the entire conceptualization process is devoid of issuer participation.</u> To put everyone on a level informational playing field, we have posted this Issuer Update to the NIRI blog. It provides a chronology of developments, an identification of key issues and, most importantly, a list of recommendations for you.

# Issuer Update: *The "Fairness" War*

Fairness, like beauty, is in the eye of the beholder! The war for "fairness" in the US equity markets has reached epic proportions despite the fact that the average investor has never had it better in terms of speed and price. The battle lines between pro and anti "lit exchange" forces are clearly drawn. And yet, the companies that are listed upon the NYSE and Nasdaq have had little say in shaping the future. Why?

**How we got here**

- It all really began circa 2004 with the SEC approval of Reg NMS along with the move of exchanges from mutual associations to for-profit enterprises.
- These fundamental changes led to a greater focus upon two dimensions of the market:
    - speed (via electronic trading) and
    - exchange profitability.
- The proliferation of "Dark Pools" (mega-sized "secret trades" made behind the scenes in unlit markets) and HFT's (High Frequency Traders) soon followed.
- Fast-forward to 2014 when Michael Lewis rocked the financial world with his *Flash Boys* claim that "the markets are rigged" and that HFT's were "ripping off billions from investors through front-running".
- In an attempt to stop this alleged front running, "Speed Bump" exchanges soon followed. They have failed, however, to gather sufficient market share (<3%, 75% of which is dark). It is now clear that, rather than the markets being "rigged" as claimed by Lewis, latency arbitrage was simply a "*tempest in a teapot*" that has now been fixed.
- More inflammatory anti-lit exchange bashing[1] surfaced with the claim that "rebates are kickbacks[2]" despite not one shred of evidence to support this thesis. Notwithstanding the lack of any substantiation of inferior executions, the "lit exchange" detractors (Dark market proponents) continued to pontificate and relentlessly cast aspersions of unfairness.

- Sensing an opportunity to attack the lit exchanges' access fee structure, the broker community and IEX (a dark exchange[3]) used their membership on the EMSAC (Equity Markets Structure Advisor Committee – from which the SEC intentionally excluded the NYSE, Nasdaq and the Issuer Community) to propose the Access Fee Pilot (AFP). The lit exchanges cried foul. Issuers were nowhere!
- The AFP was formally proposed by the SEC in March 2018 and remains highly divisive. In short, the AFP seeks to stratify exchange listed companies (we the issuers!) across four separate buckets with varying levels of rebates to test the degree to which rebates affect routing decisions.

## Post AFP Proposal Developments

- Due largely to a well-orchestrated PR campaign by the Pro-AFP faction, nearly two hundred AFP Comment Letters were submitted. You can read them at: https://www.sec.gov/comments/s7-05-18/s70518.htm. The letters can be grouped into three buckets:
    - Pro-AFP Letters from brokers, asset managers, HFT's, Dark Pools, IEX (the leading "dark exchange"[4]), and their hired proxies[5] seeking to advance their clients' financial interests. Unfortunately there were also a number of sophomoric Pro-AFP letters from pseudonyms like the supposed high-school market savant, Danny Mulson (https://www.sec.gov/comments/s7-05-18/s70518-162742.htm) and the plumber Richard P Grasso (https://www.sec.gov/comments/s7-05-18/s70518-4460578-175809.pdf) that served to undermine and corrupt the process.
    - Anti-AFP Letters from "lit exchanges" and issuers largely opposing the AFP pilot or proposing modifications. And,
    - Various Letters from academicians and other intermediaries (including Issuer Network).
- Issuers who fairly and rightfully voiced their support for the Anti-AFP position were viciously attacked (to include their Board members) by well-funded Pro-AFP intermediaries[6].
- The SEC hosted, without any issuer representation, an industry roundtable to discuss the AFP. The forum quickly regressed

into a food fight with each participant arguing in favor of his or her financial interests. Nothing was accomplished.

- The NYSE proposed an "olive branch" solution that called for a 2/3 reduction in Access Fees (to 10 mils) and a freeze on all price increases as an attempt to quell the bitter, hostile rhetoric surrounding the AFP. This well-intended proposal appears to have died on the proverbial vine as the SEC has been radio silent.
- The SEC hosted, once again without any issuer representation, an industry roundtable to discuss Data Fees. It was a nasty, ugly donnybrook with relentless cheap shots, staged insults and a disgraceful display of character assassination. You can view the spectacle at: https://www.sec.gov/video/webcast-archive-player.shtml?document_id=102518roundtable. Ironically, virtually every member of the panel had two things in common:
  - Each stated that their top priority was to protect investors, yet
  - Every panel participant had a two-comma annual compensation package (meaning in excess of a million dollars) and a financial stake in the outcome of the discussion. Ironic indeed.

Nothing was accomplished! In fact, the NYSE has posted its candid assessment of the meeting "Missed Opportunity" on its website at: https://www.nyse.com/article/a-missed-opportunity-to-enhance-us-markets?.

**Issuer Network's recommendations on where we go from here**

**SEC, please <u>immediately implement</u> the following:**

- **<u>Require full financial disclosure</u>** by business unit for all exchanges with this information being displayed quarterly on the SEC's website.
- **<u>Table the AFP</u>** and accept the NYSE "Olive Branch" Proposal.
- **<u>Develop some form of oversight mechanism</u>** (a la a Public Utility Commission) that reflects trading customer and listed issuer input pertaining to price setting. Similar strong public policies toward publicly owned, for-profit, quasi-monopolies (utilities, cable providers, etc.) already exist today.

- **Prohibit de facto self-routing** (firms routing trades to an exchange in which they have a material equity interest.) Clearly a conflict!
- **Eliminate secret trades (Dark Pools)** thereby reducing opaque markets and increasing market transparency.
- **Implement some modest level[7] of short sale disclosure** (a la MiFID).
- **Form an issuer advisory board** comprised of company CFO's, IRO's and Corporate Secretaries to represent issuer interests in market related matters. And, last but certainly not least,
- **Admonish** the disgraceful conduct**,** malicious gamesmanship and process manipulation that undermine your mission and continuously erode investor confidence in our markets.

While this war continues to escalate ostensibly in the name of fairness, let's not be so naïve. The average investor has never had it better. As is always the case on Wall Street, this is entirely about money for the big players with each gladiator sanctimoniously representing his or her own checkbook. Conversely, Issuers have no direct financial stake in any outcome other than investor fairness. Hence, the SEC would be wise to make them integral to the solution and honor their request for greater market transparency.

**Message to the SEC*: "End the War. Make our markets fair again"***

*Supporting information and links:*

- [1] For example - see NY Times Op Ed by *Macey and Swensen* at: https://www.nytimes.com/2017/07/18/opinion/wall-street-brokers-rebates-kickbacks.html?_r=0 as well as various AFP broker comment letters.
- [2] For the record - if rebates are really kickbacks, then we don't need a pilot. We need an investigation. Kickbacks are a felony and someone should go to jail!
- [3] FYI – the NYSE, Nasdaq and CBOE are "lit exchanges" with the vast majority of their volume "displayed" or "lit". IEX is a "dark exchange" by virtue of its roughly 75% "non-displayed" or

"dark" volume (versus roughly 25% lit volume). See IEX "lit volume / matched volume" trading stats at: https://iextrading.com/stats/.

- [4] Ibid
- [5] For example – see Healthy Markets (which purports to represent Transparency and Trust) Comment Letter which alleges that the NYSE "is soliciting companies over which it has significant leverage" https://www.sec.gov/comments/s7-05-18/s70518-4007255-167280.pdf and https://healthymarkets.org/about-healthy-markets/members/ as well as the CII Executive Director letter to 40 major NYSE listed issuers and their Board Members who submitted anti-AFP Comment Letters at: https://www.cii.org/files/ACCO(1).pdf .
- [6] Ibid
- [7] FYI – a monthly reporting requirement that any short seller with greater than x% of the average daily volume in a stock must disclose their long and short positions by stock.

Related links that you might find informative:

- **Jim Angel / Georgetown - "*Leave Ordinary Investors Alone*":** https://thehill.com/opinion/finance/413132-leave-ordinary-investors-out-of-the-high-speed-data-battle
- **Justin Shack / Rosenblatt - "*Who created this mess anyway*":** https://www.linkedin.com/pulse/who-created-mess-anyway-hint-wasnt-exchanges-justin-schack

We thank you for the opportunity to provide our thoughts and candid comments. We apologize if we have been excessively blunt. We welcome the opportunity to assist you in implementing any or all of our recommendations. Let us all please work together to put aside economic self-interest in favor of more transparency, fairness and efficiency.

Thank you,

**Patrick J. Healy, Founder and CEO**
**Issuer Network**
[redacted]
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