MODERN MARKETS INITIATIVE

January 4, 2024

By electronic mail to rule-comments@sec.gov

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: **Volume-Based Exchange Transaction Pricing for NMS Stocks (Release No. 34- 98766; File No. S7-18-23)**

Dear Ms. Countryman:

Modern Markets Initiative ("MMI"), the education and advocacy organization devoted to the role of technological innovation in creating the world's best markets, appreciates the opportunity to provide written comments to the U.S. Securities and Exchange Commission (the "SEC" or "Commission") in connection with Volume-Based Exchange Transaction Pricing for NMS Stocks (Release No. 34- 98766; File No. S7-18-23, or the "Proposal").

MMI members collectively employ more than 2000 people in over 50 markets globally, and account for approximately 20 percent of daily trading volume in the US equity markets. MMI's members deploy automated trading technology systems to enhance efficiency of trading for investors.

I. Best Markets Ever for Investors

The US equity markets are the envy of the world for investors, with the most liquid markets and lowest-cost trading. With more than 60% of Americans invested directly or indirectly through a 401k, 529, pension, or ABLE plan, it is vital that any changes to the equity markets be narrowly drafted, addressing a real-world rather than theoretical problem, so as not to disrupt what is working well. As detailed in MMI's 2023 study, "Stability in Turbulent Times: A Quantitative Analysis of the Liquidity and Narrowed Bid-Ask Spreads Provided by Automated Trading," there has never been a more cost-effective or efficient time to be a retail investor. As a result of market automation, the cost of trading shrank more than 50% over the past decade through narrowed bid-ask spreads, and this has resulted in 30% more investor lifetime savings. Simply put, investors have never had it better as far as low-cost trading and dependable liquidity.[1]

[1] "2023 Stability in Turbulent Times: A Quantitative Analysis of the Liquidity and Narrowed Bid-Ask Spreads Provided by Automated Trading," MMI Study (June 2023).

II. **<u>Support for Transparency</u>**

MMI stands in support of transparency. Transparency delivers investors a more efficient market by providing the best price through healthy competition. Transparent markets give investors greater confidence by providing the best information about market prices, how orders are being handled and how markets are operating. As such, MMI believes it is in the public interest to have greater transparency to ensure full disclosure of pricing systems to the public. Further transparency could help shed light on actual, rather than assumed, market behavior, practices and arrangements with respect to volume based exchange transaction pricing, and allow for more informed discussion of the subject matter of the Proposal.

At present, there is insufficient public data available to provide meaningful insight on the practice of volume-based exchange transaction pricing for NMS stocks. Data (rather than assumptions) are necessary to make a more informed review of business practices with respect to volume based exchange transaction pricing, and evaluate the extent to which, if at all, problems arise.

III. **<u>Concerns Regarding Proposal</u>**

MMI's concerns regarding the Proposal include:

- **<u>Lack of Clearly Defined Problem Proven to Exist:</u>** MMI is concerned that the Commission does not substantiate the purported benefits of the various "bans" on volume discounts, nor that there is any actual problem in need of a solution. The Commission should clearly articulate the real-world problem to be solved and demonstrate through data that the problem is real and not conjecture. Likewise, the Commission should quantify the Proposal's costs and benefits. The Proposal's discussion of market behavior, practices and arrangements appears based on assumptions rather than facts, casting doubt on whether there is a reasonable analysis of the costs versus benefit.

- **<u>Potential to Drive More Trading from Lit to Dark Markets:</u>** Removing tiered fees for liquidity providers could diminish their willingness to trade. The Commission barely acknowledges this obvious risk in the Proposal and makes no attempt to analyze it. Further, as noted below, the Commission fails to analyze how much liquidity is added to the market in the form of "Agency" orders. Based on this failure alone, the Commission must retract the Proposal.

- **<u>Potential Negative Impact on Smaller Firms</u>**: Some smaller brokerage firms route their order flow through larger intermediaries to take advantage of efficiencies and obtain more favorable rate structures, in effect benefiting from tiering. Eliminating the tiers may have an outsized negative effect on the economics of such small firms.

- **<u>Problematic Distinctions Regarding Terminology - "Agency" v. “Riskless principal” v. “principal”:</u>** The definitions used in the Proposal are problematic and conflict with industry terms of art. In particular:
  - The use of the categories “Agency”, etc., are imprecise and likely harmfully so. Some exchanges already require a broker to mark each order as “Agent” or “Principal,” so these terms are well-known and already present in the exchanges’ trading data.
  - However, these terms lack any direct correlation to categories of “retail,” “professional,” or “liquidity provider”, etc., and therefore do not provide precise definitions or bracketing of the proposed rule or its intended objectives.
  - In fact, numerous professional trading firms are not members of all (or any) exchanges and route their orders through exchange member broker-dealers to access those markets. A single firm’s orders may be marked “Agency” on one exchange and “Principal” on another.
  - Further, some of those professional trading firms are very significant liquidity providers. The proposed rule, by lumping this activity into “Agency” and by eliminating tiered pricing for it, would likely have a significant negative effect on market liquidity – driving such liquidity off-exchange or eliminating it completely.
  - Rather, if the proposed rule identifies an actual harm to address, the rule should propose a specific definition of order flow that fits the objective. (MMI notes that options exchanges for more than a decade have had a “Professional Customer” rule, which requires broker/members to mark orders of such customers, so that certain exchange rules and trading protocols may be implemented. This definition more accurately targets its intended audience and purpose. Similarly, a new definition may be more appropriate for the volume-based pricing tiers rule – if any such rule is appropriate at all.)

- **<u>Absence of Economic Analysis of Interaction with Other Pending Equity Market Structure Proposals</u>**: There is no economic analysis on the interaction of this Proposal with the Commission’s other pending proposals, such as Best Execution and Tick Size (designed to incent exchanges to be more competitive), or how the proposals might interact with each other’s policy objectives. In fact, MMI members believe it is quite impossible for anyone to reasonably predict the interactions among so many pending rules, and the SEC would be introducing unnecessary risk to the markets to enact so many proposals in a short time, without pause for in-depth study of the economic impact of each one individually and collectively.

<u>IV. Answers to Questions Presented</u>

<u>Q4: (p. 30) To what extent is volume-based exchange transaction pricing used by exchanges to attract specific types of members or customers of members, such as proprietary traders, registered market makers, or agency customers? Among agency customers, are any particular types of customers particularly attracted by volume-based exchange transaction pricing, such as long-term investors, short-term traders, investment advisers, and institutional investors?</u>

As proposed, non-registered trading firms that provide liquidity would be considered "agency order flow" and as such would no longer get advantageous pricing. This would reduce interest in providing liquidity, and such non-registered trading firms will quote less, reducing liquidity.

Q9. (p. 32) Is the proposed definition of riskless principal in proposed Rule 6b-1(a) appropriate? Why or why not? If the definition included a "same price" requirement, do commenters agree that the Commission would not be able to achieve its objectives for the proposed rule? Why or why not?

This part of the Proposal has several problems. First, the Proposal includes a new definition of "riskless principal" that is not entirely consistent with other industry definitions of the term, which stands to cause confusion and lead to non-compliance.

Second, "riskless principal" is not a capacity that firms transmit to exchanges today. Routing firms and exchanges would have to adopt new messaging and internal changes to accommodate its use for this purpose.

Third, as noted above, the use of the order flow Capacity field ("Agency", "Principal", or now "Riskless Principal") is misguided and imprecise. None of those values equates cleanly or helpfully to identifying retail or professional order flow, as the Commission seeks to do.

Q 31 (p. 180) Is there a lack of transparency for exchange price schedules? Does a lack of information on how many exchange members qualify for each volume-based tier in a given month inhibit public comment on exchange fees?

MMI believes additional transparency about exchange price schedules could have benefits, for example allowing the public to ascertain whether a pricing schedule benefits just one firm or multiple firms.

In particular, transparency would be invited in providing further data on practices including:

- The number of firms benefited per pricing tier;
- Extent to which "step-ups" incent liquidity provision on an exchange;

However, MMI also notes that, as drafted, this transparency concept is vague, with minimal detail, and no users or use case(s) named for it. As the Commission has recently noticed with legacy Rule 605 (which was poorly conceived from the beginning), simply publishing data without a clear understanding of its use may be an expensive folly. MMI encourages the Commission to more fully explain the intended use of this information, by whom, and how – and to then define the reporting requirements specifically so as to support these goals.

Q 33 (p. 180) Does volume-based transaction pricing promote concentration in the broker-dealer business? Specifically, does it offer an advantage to larger broker-dealers that makes it harder for small broker-dealers to compete? Does this make it more difficult for new broker-dealers to enter the NMS equity brokerage business than it would be without volume-based transaction pricing?

Brokers of all sizes take advantage of economies of scale and volume-based discounts. Smaller brokers can route through intermediaries to obtain better pricing and discounts of economies of scale. Eliminating this ability to have volume-discounts could harm rather than help smaller firms.

Q 61 (p. 184) Do commenters agree with the Commission's assessment of the impact of the proposed rule on efficiency, competition, and capital formation?

MMI reiterates that the US equity markets are the envy of the world. Without empirical analysis that identifies the problem this Proposal may solve, its impact on efficiency, competition and capital formation remains uncertain, particularly given its potential interaction with the many other pending equity market structure proposals.

V. Conclusion

MMI appreciates the opportunity to provide feedback to the Commission. MMI recommends that consideration of the Proposal be bifurcated to focus first on transparency provisions, after which further public discourse, roundtables, and analysis of the transparency disclosures should be conducted to identify whether actionable problems exist.

Thank you for your consideration.

Very truly yours,

Kirsten Wegner
Chief Executive Officer
Modern Markets Initiative

Cc: The Honorable Gary Gensler, Chairman, SEC
The Honorable Caroline A. Crenshaw, Commissioner, SEC
The Honorable Hester M. Peirce, Commissioner, SEC
The Honorable Jaime Lizárraga, Commissioner, SEC
The Honorable Mark T. Uyeda, Commissioner
SEC Director Haoxiang Zhu, Division of Trading and Markets