Hope M. Jarkowski
General Counsel
New York Stock Exchange
11 Wall Street
New York, NY 10005

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Via Electronic Mail: rule-comments@sec.gov

J. Matthew DeLesDernier
Deputy Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Re: Volume-Based Exchange Transaction Pricing for NMS Stocks (Exchange Act Release No. 98,766, 88 FR 76282 (Nov. 6, 2023)); File No. S7-18-23

Dear Mr. DeLesDernier:

NYSE Group, Inc. ("NYSE Group"), on behalf of New York Stock Exchange LLC ("NYSE"), NYSE Arca, Inc., NYSE American LLC and NYSE National, Inc., appreciates the opportunity to submit comments to the U.S. Securities and Exchange Commission (the "Commission" or "SEC") regarding the Commission's proposal to prohibit national securities exchanges from offering volume-based transaction pricing in connection with the execution of agency-related orders in certain stocks (the "Proposal").[1]

Executive Summary

We strongly urge the Commission to abandon the Proposal. The Proposal suffers from myriad shortcomings, all of which stem from the Commission's incomplete understanding of the reasons that broker-dealers engage in agency order flow, its selective view of competition in the market and its failure to actually identify a regulatory problem that needs to be solved. As the U.S. Court of Appeals for the D.C. Circuit explained in 2020 when it struck down the Commission's Transaction Fee Pilot rulemaking, agency rules "are not adopted in search of regulatory problems to solve; they are adopted to correct problems with existing regulatory requirements."[2] The Proposal is eerily reminiscent of the Commission's Transaction Fee Pilot. The Commission should withdraw it.

Our letter is organized into eight sections addressing the following points:

I. The Proposal would harm competition.

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1 Volume-Based Exchange Transaction Pricing for NMS Stocks, Exchange Act Release No. 98,766, 88 FR 76282 (Nov. 6, 2023) [hereinafter Proposing Release].

2 *New York Stock Exch. LLC v. SEC*, 962 F.3d 541, 556–57 (D.C. Cir. 2020).

II. The Proposal fails to identify or demonstrate an actual regulatory or market problem that needs to be solved.

III. The Commission has not identified a justification for such a significant change in its long-standing policy on this topic.

IV. The Proposal suffers from a lack of reasoned decision-making under the APA.

V. The Proposal fails to consider interconnections and cumulative effects of different proposals, laws and regulations.

VI. The Proposal fails to satisfy other required rulemaking requirements and burdens.

VII. The Proposal fails to adhere to SEC staff rulemaking guidance.

VIII. The Proposal fails to adequately consider reasonable—and constructive—alternatives.

Discussion

I. The Proposal Would Harm Competition

The Commission attempts to justify the Proposal by arguing that volume-based pricing may raise various competitive concerns—and that the Proposal would enhance the competitive landscape. But to the contrary, the Proposal would actually impede and, in some cases, restrict, competitive forces in a number of important respects.

As a foundational matter, volume-based pricing arrangements are widely accepted across industries throughout the U.S. and global economy, and are generally considered pro-competitive under U.S. antitrust law.[3] The Commission has failed to explain why volume-based pricing practices by exchanges are inappropriate or different. In her dissenting statement on the Proposal, Commissioner Peirce observed:

> Economies of scale trigger discounts in almost every industry. You buy in bulk, and you pay less. Why should similar discounts be unavailable in this industry?[4]

In his dissenting statement on the Proposal, Commissioner Uyeda noted that:

> A key component of a market-based economy is the freedom to develop pricing mechanisms. These

[3] *See* Phillip E. Areeda and Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶ 749 (5th ed. 2023).

[4] Commissioner Hester M. Peirce, *Fears for Tiers: Statement on Proposed Volume-Based Exchange Transaction Pricing for NMS Stocks*, SEC (Oct. 18, 2023), https://www.sec.gov/news/statement/statement-peirce-proposed-volume-based-exchange-transaction-pricing-nms-10-18-2023.

> mechanisms may range from the pricing of various bundles of goods and services to everyday volume discounts that retailers receive from wholesalers when they purchase their supplies. Prices and price mechanisms send signals that optimize the allocation of scarce resources and is a far superior alternative than central planning.[5]

By imposing a blanket ban on volume-based pricing for agency order flow, the Commission is attempting to unlawfully exceed its statutorily prescribed function. As it relates to fees and rebates set by exchanges, the Commission is only authorized to ensure a given fee filing is consistent with the Securities Exchange Act of 1934 ("Exchange Act"). Yet the Proposal attempts to contort the Commission's role to that of a rate setter, establishing a categorical ban on exchange pricing models in place of an individualized analysis of whether a particular fee filing "is designed to permit unfair discrimination between customers, issuers, brokers, or dealers."[6] This role is simply not supported by the Exchange Act.

The Proposal Would Harm Exchange vs. Exchange Competition

By eliminating exchanges' ability to offer volume-based transaction pricing in connection with the execution of agency-related orders in NMS stocks,[7] the Proposal would eliminate one of the ways in which exchanges can compete with, and endeavor to differentiate themselves against, other exchanges. As such, the Proposal would impede exchange vs. exchange competition.

The Proposal posits that closing auction pricing tiers that involve discounts based on an exchange member's overall trading volume on the same exchange are a form of illegal tying or conditional pricing.[8] But the Proposal fails to identify any coercive or exclusionary act—or any exchange's power to coerce—that results from such discounts. The Proposal presents no evidence that the bundling discounts decrease broker-dealers' choices among exchanges. While the Proposal relies on academic literature suggesting negative outcomes of bundling in other contexts, it presents no specific evidence or facts to support its conclusions in the context at hand.[9]

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[5] Commissioner Mark T. Uyeda, *Statement on Volume-Based Exchange Transaction Pricing for NMS Stocks*, SEC (Oct. 18, 2023), https://www.sec.gov/news/statement/uyeda-statement-volume-based-rebates-and-fees-101823.

[6] 15 U.S.C. § 78f(b)(5).

[7] Given that the Proposal only addresses NMS stocks, this letter does not analyze the impact of the Proposal on other markets, such as options. However, the Commission requests comment on whether the Proposal should be applied to options. *See* Proposing Release at 76292. Applying the Proposal to options would only further exacerbate the issues highlighted in this letter. If there were such an expansion, NYSE Group would comment on it forcefully.

[8] Proposing Release at 76304.

[9] *See id.* at 76304–05.

As suggested in the Proposal, several exchanges also offer similar competitive discounts,[10] which can include various requirements for achieving a better tier.[11] This means that far from exclusionary conduct by an entity with market power, volume-based pricing is a means by which exchanges compete with each other. In the case of the closing auction, broker-dealers have several alternatives to obtain the closing price on venues other than the listing exchanges.[12] As such, the exchange pricing practices that the Proposal targets actually foster competition, and eliminating them would put an unjustified burden on competition.

The Proposal Would Harm Competition Between Exchanges and Off-Exchange Venues

Next, the Proposal would exacerbate existing competitive issues and concerns created by the regulatory disparities between different types of market centers—national securities exchanges on the one hand, and off-exchange market centers, alternative trading systems ("ATS") and broker-dealers, on the other hand. The Proposal would prohibit volume-based transaction pricing for agency orders in NMS stocks by national securities exchanges, but not other types of market centers.[13] The Proposal does not explain why this disparate treatment—which will further widen the regulatory advantages that benefit non-exchange market centers—is appropriate or beneficial to competition.

More fundamentally, if the Commission's primary concern is that volume-based pricing creates problematic conflicts of interest for broker-dealers, then that concern should also apply in equal force in the context of non-exchange trading venues. The Commission has failed to address this important point.

Speaking more broadly, imposing an asymmetrical regulatory restriction on exchanges but not other types of market centers may have the effect of driving more trading to off-exchange venues. This result would be incongruous with broader policy concerns that Chair Gensler has repeatedly articulated when discussing the increasing proportion of overall trading volume occurring off-exchange, and the policy consequences of that trend. In a June 2022 speech, for example, Chair Gensler observed that:

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10 *See id.*

11 *See, e.g.*, *Price List - Trading Connectivity*, Nasdaq, https://nasdaqtrader.com/Trader.aspx?id=PriceListTrading2, showing that the Nasdaq Stock Market rebate schedule includes requirements for MELO Orders, midpoint orders, Designated Retail Orders, options trading activity, and other hurdles as qualification requirements for tiered rates for firms adding liquidity.

12 *See* Proposing Release at 76304–05.

13 Commission staff recently approved the application of the Financial Industry Regulatory Authority ("FINRA") to add IntelligentCross ATS as a new entrant to the Alternative Display Facility. *See* Exchange Act Release No. 98,212 (Aug. 24, 2023), 88 FR 59958 (Aug. 30, 2023) (SR-FINRA-2022-032). As that approval shows, non-exchange electronic communications networks and ATSs compete with exchanges for displayed trading—but under the Proposal, the ban on applying volume tier rebates to agency flow would apply only to exchanges, not to their ATS competitors.

> Right now, there isn't a level playing field among different parts of the market: wholesalers, dark pools, and lit exchanges. Further, the markets have become increasingly hidden from view. In 2009, off-exchange trading accounted for a quarter of U.S. equity volume. Last year, during the meme stock events, that share swelled to a peak of 47 percent. What's more, 90-plus percent of retail marketable orders are routed to a small, concentrated group of wholesalers that pay for this retail market order flow.
>
> It's not clear, with such market segmentation and concentration, and with an uneven playing field, that our current national market system is as fair and competitive as possible for investors.[14]

In a December 2022 statement discussing the Commission's proposals to amend minimum pricing increments and access fee caps (among other things), Chair Gensler stated that:

> A large and growing amount of equity trading now goes into what many call the dark markets, particularly off-exchange market centers such as wholesalers and dark pools. Such off-exchange market centers, though, benefit from transacting using a different set of rules from the ones on national securities exchanges. This may undermine competition . . . . Thus, I am glad to support today's proposal. Consistent with our mandate, guided by economic analysis, and shaped by public opinion, this proposal would enhance efficiency, competition, and fairness across our equity markets. That gets to the heart of our mission.[15]

In its December 2022 proposals, the Commission left unscathed off-exchange venues' ability to use practices like payment for order flow to attract agency orders. But now, the Proposal would hamstring the ability of exchanges to compete with off-exchange venues to attract such agency flow, by preventing exchanges from offering volume-based incentives to broker-dealers sending such agency flow to exchanges. In light of these concerns, and other agency initiatives that are motivated, at least in part, by addressing the "uneven playing field" that Chair Gensler observed, it is unclear why the Commission would seek to apply volume-based pricing limits on exchanges but *not* other types of market centers.

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14 Chair Gary Gensler, *"Market Structure and the Retail Investor:" Remarks Before the Piper Sandler Global Exchange Conference*, SEC (June 8, 2022), https://www.sec.gov/news/speech/gensler-remarks-piper-sandler-global-exchange-conference-060822.

15 *SEC Proposes Rules to Amend Minimum Pricing Increments and Access Fee Caps and to Enhance the Transparency of Better Priced Orders*, SEC (Dec. 14, 2022), https://www.sec.gov/news/press-release/2022-224.

This disparate treatment repeats a core problem that the D.C. Circuit identified when rejecting the Commission's Transaction Fee Pilot in 2020: "Because the Rule applies only to exchanges, not to off-exchange venues, it . . . disadvantages securities exchanges in comparison with ATSs and other off-exchange trading venues with which exchanges directly compete to attract order flow."[16] The Proposal suffers from the same problem. Like the Transaction Fee Pilot, the Proposal has "failed to provide a reasoned justification for . . . exempting off-exchange trading venues from new regulatory restrictions that will impede exchanges' ability to attract order flow."[17] If the Proposal were to be finalized in its current form, the Commission would be picking winners and losers, flagrantly favoring non-exchange market centers over exchanges. The Commission's failure to provide an adequate justification for discriminatory and anticompetitive features of the Proposal violates both the Administrative Procedure Act ("APA") and its obligation under the Exchange Act to refrain from adopting any "rule or regulation which would impose a burden on competition not necessary or appropriate."[18]

The Proposal Would Harm Broker-Dealer vs. Broker-Dealer Competition

The Proposal would also have negative consequences for exchange members and their customers. Broker-dealers compete against other broker-dealers for order flow. Volume-based pricing helps facilitate competition among broker-dealers: it incentivizes broker-dealers to post favorable pricing and provide innovative and diverse offerings to market participants. This helps drive volume in their direction. The Proposal could significantly reduce the associated benefits (*e.g.*, cost savings, innovation and choice) for investors by removing a competitive pricing tool that ultimately contributes to greater liquidity and price efficiency in the market for NMS stocks. These negative consequences would extend far beyond the agency orders the Commission attempts to capture. This is because the Proposal lumps together two distinct types of orders into what it defines as "agency" orders: (a) proprietary orders submitted by firms transacting on their own behalf but who are not members of a particular exchange and must submit such order flow through an exchange member and (b) customer orders from smaller broker-dealers.[19] The former is, for all practical purposes, a proprietary order, yet the Commission classifies it as an agency order. Thus, many proprietary orders submitted by broker-dealers would be inappropriately excluded from volume-based incentive calculations due to this misclassification of what constitutes an agency order.

The Proposal would also hinder smaller broker-dealers' ability to compete. Some smaller broker-dealers send their orders to exchanges through larger broker-dealers for

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16 *New York Stock Exch. LLC*, 962 F.3d 541, 550–51 (quoting Brief for Petitioners, at 21–22).

17 *Id.*

18 15 U.S.C. § 78w(a)(2); *see also Steger v. Def. Investigative Serv. Dep't of Def.*, 717 F.2d 1402, 1406 (D.C. Cir. 1983) ("The [agency] cannot, despite its considerable discretion, treat similar situations dissimilarly and, indeed, can be said to be at its most arbitrary when it does so.").

19 *See* Proposing Release at 76289–90.

reasons that may have nothing to do with exchange volume-based pricing. For such lower-volume broker-dealers, the costs and necessary infrastructure associated with connecting directly with exchanges may not be worthwhile if they can gain access another way. By using such a sponsored-access relationship with a larger broker-dealer, smaller broker-dealers may avoid costs associated with becoming members of each exchange themselves (and paying the associated membership fees),[20] purchasing direct market-data feeds from exchanges and devoting the resources needed to run their own smart order router. In order to continue to participate in exchange volume-based pricing, smaller broker-dealers would themselves be required to become members of exchanges, which could include the costs mentioned above.

And the Proposal would increase costs for larger broker-dealers as well. Currently, higher-volume broker-dealers can sponsor smaller firms' access while sharing the expensive fixed costs associated with accessing the highly complex U.S. equities market. In doing so, the higher-volume broker-dealer can decrease the costs associated with sponsoring another broker-dealer through the transaction pricing it receives from reaching a volume-based tier. The Proposal could remove or lower the benefits that help defray these sponsorship costs. This could lead to larger broker-dealers charging more for sponsored access, which would also raise costs for smaller broker-dealers and further hinder their ability to compete.

Finally, the Proposal does not adequately consider the negative effect that it would have on smaller broker-dealers' ability to compete with larger firms' trading strategies. The ability of larger broker-dealers to provide exchange access to smaller firms at a cost similar to what the larger broker-dealers enjoy means that in at least some situations, smaller firms' market-making strategies compete with the larger firms' strategies. If agency orders were no longer permitted to count toward the larger firms' volume-based pricing tiers, the rates for trading smaller firms' orders on-exchange would almost certainly be worse than the rates available to larger exchange member firms trading on a principal basis. This would reduce the opportunity for smaller firms' trading strategies to compete with the larger firms' strategies, reducing broker-dealer competition overall.

II. The Proposal Fails To Identify or Demonstrate an Actual Regulatory or Market Problem that Needs To Be Solved

One of the fundamental tenets of reasoned decision-making under the APA is that an agency must demonstrate that an actual problem or harm exists—through the identification of evidence—that necessitates the given rulemaking.[21]

The Proposal fails to do this. Nowhere in the 200 pages of the Proposing Release has the Commission identified or demonstrated the existence of an actual problem, harm or impediment to investor protection, market functioning or capital formation caused by exchanges offering volume-based transaction pricing in connection with the execution of agency-related orders. Instead, the Commission has justified the Proposal based on potential harms and problems that "may" or "could" exist.

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[20] *Id.* at 76287 n.40.

[21] *See Mendoza v. Perez,* 754 F.3d 1002, 1021 (D.C. Cir. 2014).

The Proposal lists a series of possible concerns, but fails to actually conclude that there is a regulatory problem that necessitates this rulemaking. The Proposal states, for example, that:

- The Commission is "concerned that exchanges' tiered transaction pricing *may* confer an inappropriate benefit on a small group of members to the detriment of other members by offering the best prices (*i.e.*, the lowest fees and highest rebates) only to the exchange's highest volume members;"[22]

- Lower-volume members "*may* find it difficult to compete for customer order flow because they are unable to pass through to customers the favorable exchange transaction pricing or lower commissions that are available to higher-volume members;"[23] and

- Lower-volume members "*may* seek to route some or all of their orders through high-volume members to qualify for better exchange pricing."[24]

Commissioner Peirce summarized this dynamic well in her dissenting statement. She noted that:

> In proposing to restrict volume-based pricing tiers, the Commission points to concerns about unwarranted pricing inequities, concentration, and restraints on competition. If strong data substantiated these concerns, a rulemaking could be an appropriate response. However, rather than provide evidence of definitive harms currently happening, the release muses repeatedly about what "may" happen.[25]

Given its vague and tentative suggestions concerning potential and possible—rather than established—harms or problems, the Proposal is similar to the Commission's Transaction Fee Pilot rulemaking, which the D.C. Circuit struck down in 2020. In its order vacating that rulemaking, the court explained that the Commission had failed to identify a regulatory problem that the pilot initiative would solve. As stated by the court:

> [U]nless an agency's authorizing statute says otherwise, an agency regulation must be designed to address identified problems. Rules are not adopted in search of regulatory problems to solve; they are adopted to correct problems with

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22 Proposing Release at 76285 (emphasis added).

23 *Id.* at 76284 (emphasis added).

24 *Id.* (emphasis added).

25 Commissioner Hester M. Peirce, *Fears for Tiers: Statement on Proposed Volume-Based Exchange Transaction Pricing for NMS Stocks*, SEC (Oct. 18, 2023), https://www.sec.gov/news/statement/statement-peirce-proposed-volume-based-exchange-transaction-pricing-nms-10-18-2023.

> existing regulatory requirements that an agency has delegated authority to address.[26]

The Proposal suffers from similar problems and deficiencies. Put simply, the Proposal fails to establish that a "genuine problem" actually exists.[27] Thus, the Commission has not met its required burden to justify the rulemaking. The SEC has no explicit or implicit authority to adopt a rule to address an ostensible problem that it has not established exists.

III. The Commission Has Not Identified a Justification for Such a Significant Change in its Long-Standing Policy on This Topic

The Commission's Proposal appears even more ill-conceived—and arbitrary and capricious—when considered within the context of (a) the statutory construct under the Exchange Act and SEC rules that govern the Commission's and SEC staff's active oversight over exchanges and their fees and rule books, coupled with (b) the agency's prior review and assent to the volume-based transaction pricing arrangements that the Proposal would now prohibit.[28]

As context, the Exchange Act provides that a proposed exchange rule change may not take effect unless it is approved by the Commission pursuant to Exchange Act Section 19(b)(2), or it becomes immediately effective upon filing pursuant to Exchange Act Section 19(b)(3)(A).[29] Rule 19b-4(f) under the Exchange Act specifies the types of proposed rule changes that may become immediately effective upon filing with the Commission, and includes those properly designated by an exchange as "[e]stablishing or changing a due, fee, or other charge" imposed by the exchange.[30] Whether filed for Commission approval or having immediate effectiveness, all proposed rule changes, including proposed fee changes, are required to be consistent with the Exchange Act.

The Exchange Act provides the Commission with the ability to take action if the agency determines or is concerned that a given filing may not satisfy all relevant legal and regulatory requirements. The Commission may temporarily suspend a fee filing and issue an order instituting proceedings to demonstrate whether the filing satisfies applicable standards.[31]

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[26] *New York Stock Exch. LLC*, 962 F.3d 541, 556–57 (citation omitted).

[27] *Chamber of Com. of the United States v. SEC*, 85 F.4th 760, 778 (5th Cir. 2023) ("The SEC must therefore show that opportunistic or improperly motivated buybacks are a genuine problem even under its theory of investor uncertainty. Because the agency has not done so, the first benefit is inadequately substantiated.").

[28] *See infra* notes 32–33 and accompanying discussion.

[29] 15 U.S.C. § 78s(b)(2)–(3).

[30] 17 C.F.R. § 240.19b-4(f).

[31] 15 U.S.C. § 78s(b).

Over many years, the Commission and its staff have reviewed dozens if not hundreds of fee filings that include volume-based pricing and have permitted exchanges' practices of offering volume-based pricing in connection with the execution of agency-related orders. In 2023 alone, the Commission has reviewed and permitted at least 10 volume-based pricing fee changes submitted by NYSE Group exchanges.[32] This is in addition to the other volume-based pricing fee changes submitted by other exchanges that the Commission permitted. In permitting each of those fee filings to become effective, the Commission tacitly agreed with these exchanges that their volume-based pricing proposals were consistent with the Exchange Act.

The Proposal is an abrupt departure from the Commission's long-standing practice of permitting volume-based pricing. But critically, the Commission has failed to identify or explain what, if any, changes in the marketplace, the law or the broader economy would justify its dramatic change in policy around exchange pricing practices that heretofore the agency has reviewed and regarded to be consistent with the Exchange Act. Courts have stated that reasoned decision-making, at a minimum, demands that an agency acknowledge and explain the reasons for a changed interpretation or approach.[33] Changing course on a long-standing policy issue is arbitrary and capricious unless the agency adequately considers and explains its rationale for the change.

IV. The Proposal Suffers from a Lack of Reasoned Decision-Making Under the APA

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32 *See, e.g.*, Exchange Act Release Nos. 96,680 (Jan. 17, 2023), 88 FR 4047 (Jan. 23, 2023) (SR-NYSEARCA-2023-01); 97,106 (Mar. 10, 2023), 88 FR 16295 (Mar. 16, 2023) (SR-NYSEARCA-2023-21); 97,170 (Mar. 20, 2023), 88 FR 17907 (Mar. 24, 2023) (SR-NYSE-2023-18); 97,296 (Apr. 13, 2023), 88 FR 24254 (Apr. 19, 2023) (SR-NYSEAMER-2023-25); 97,504 (May 15, 2023), 88 FR 31835 (May 18, 2023) (SR-NYSEARCA-2023-36); 97,681 (June 9, 2023), 88 FR 39275 (June 15, 2023) (SR-NYSEARCA-2023-39); 97,909 (July 14, 2023), 88 FR 46820 (July 20, 2023) (SR-NYSE-2023-26); 98,136 (Aug. 15, 2023), 88 FR 56903 (Aug. 21, 2023) (SR-NYSEARCA-2023-52); 98,495 (Sept. 25, 2023), 88 FR 67414 (Sept. 29, 2023) (SR-NYSENAT-2023-20); and 98,953 (Nov. 15, 2023), 88 FR 81114 (Nov. 21, 2023) (SR-NYSE-2023-41).

33 See *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (noting the requirement that an agency must provide a "reasoned explanation for its action"); *see also*, *Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 222 (2016) (finding that a Department of Labor regulation "was issued without the reasoned explanation that was required in light of the Department's change in position and the significant reliance interests involved"); *Dep't of Homeland Sec. v. Regents of the Univ. of Cal.*, 140 S.Ct. 1891, 1913 (2020) (noting that "[w]hen an agency changes course, as DHS did here, it must be cognizant that longstanding policies may have engendered serious reliance interests that must be taken into account") (internal citation omitted); *Physicians for Soc. Resp. v. Wheeler*, 956 F.3d 634, 646 (D.C. Cir. 2020) (reversing dismissal of a complaint alleging that an Environmental Protection Agency directive was arbitrary and capricious because "[r]egardless of whether the Directive[] . . . might have been sufficient to *acknowledge* EPA's change in policy, the Directive and its accompanying Memorandum failed to 'provide a reasoned explanation for the change'" (quoting *Encino Motorcars*, 579 U.S. at 221)); *Kornitzky Grp., LLC v. Elwell*, 929 F.3d 737, 743, 745 (D.C. Cir. 2019) (setting aside a determination by the National Transportation Board where "the Board failed to make a finding of subjective knowledge as required by its own precedent" without "indicat[ing] that [it] intend[ed] to abandon its subjective-knowledge requirement").

In several respects, the Proposal reflects a lack of reasoned decision-making required by the APA.

First, broker-dealers' sharing of discounts and rebates with their customers, and dynamics relating to those practices, are important elements of the Commission's purported justification for the Proposal. But the Commission's discussion of this topic, including its observations relating to fee and rebate-related practices, are inconsistent within the Proposal.

- On the one hand, the Proposal states that lower-volume exchange members "may find it difficult to compete for customer order flow because they are unable to pass through to customers the favorable exchange transaction pricing or lower commissions that are available to higher-volume members."[34] The Proposal makes this statement in support of its argument that the practice of higher-volume exchange members sharing of discounts and rebates with their customers "may" be anti-competitive. The implication, according to the Proposal, is that higher-volume exchange members are able to pass through to their customers significant fee-savings, enabling them to offer cheaper rates than lower-volume members.

- On the other hand, another portion of the Proposal applies an inconsistent factual predicate to support its contention concerning potential conflicts of interest between broker-dealers and their customers. The Proposal states that in some cases exchange members may not actually share discounts and rebates with their customers.[35]

To summarize, in an effort to support one of its primary justifications for the Proposal, the Commission states that higher-volume exchange members share incentives with their customers, which may be anti-competitive. But to support a different justification for the Proposal, the Commission states that broker-dealers may not actually share incentives with customers.

These are not minor or inconsequential points or concerns. They go to the very core of the Commission's justification for the Proposal. The fact that the Commission is (a) unsure whether broker-dealers share pricing incentives with their customers and/or (b) is

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[34] Proposing Release at 76284.

[35] *See id*. at 76284–85 (volume-based transaction pricing "*may* provide incentives to members of more than one exchange to route orders to one particular exchange in order to qualify for that exchange's tiers and achieve lower fees and higher rebates as a result[,] . . . [which] can present a conflict of interest between members and customers when members do not fully pass-through exchange transaction fees and rebates to their customers and instead retain for themselves the benefits of tiered exchange transaction pricing.") (emphasis added).

inconsistent in its views on the practice and its implications, together reflect an "error [that] permeates—and therefore infects—the entire rule."[36]

The Proposal actually acknowledges the agency's confusion on this topic when it states that "[t]he extent to which any such pass-through transaction pricing is provided to sponsored customers is uncertain because these arrangements are not disclosed."[37] In line with what several judges found with respect to the Commission's recently challenged share repurchase rule, here too the Commission's "theory is internally contradictory and thus fails adequately to substantiate the rule's . . . benefit."[38] These inconsistencies further illustrate that additional Commission fact-finding, thinking and analysis is needed before any policy changes are made in this area.

Second, the Proposal would require an exchange "to have a rule to require its members to engage in practices that facilitate the exchange's ability to comply with the prohibition on volume-based exchange transaction pricing in connection with the execution of agency-related volume."[39] The Proposal would also require exchanges to "establish, maintain and enforce written policies and procedures reasonably designed to detect and deter members from receiving volume-based exchange transaction pricing in connection with the execution of agency or riskless principle orders in NMS stocks."[40]

But, as the Proposal explicitly acknowledges, exchanges are *already* required to establish, maintain and enforce written policies to detect and deter non-compliance with their rules, the federal securities laws generally and applicable SEC rules.[41] But the Commission has not explained why it would impose a new requirement on exchanges that the Commission acknowledges is duplicative of an existing requirement. This is inappropriate and would violate the APA.[42]

Third, the Proposal would require exchanges to submit to the Commission, within five calendar days after the end of each calendar month, information related to the volume-

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[36] *Chamber of Com. of the United States v. SEC*, 85 F.4th 760, 778–79 (5th Cir. 2023) ("The SEC cannot have it both ways. It is illogical for the rule simultaneously to accept and to reject the reasoning underlying the price discovery benefit.").

[37] Proposing Release at 76287.

[38] *Chamber of Com. of the United States*, 85 F.4th at 778.

[39] Proposing Release at 76288.

[40] *Id.*

[41] *Id.* at 76293 ("While exchanges generally already establish, maintain, and enforce written policies to detect and deter non-compliance with their rules and the Federal securities laws and rules to ensure compliance with their obligations under the Exchange Act, the Commission is adding a specific and complementary requirement in proposed Rule 6b–1 to help ensure exchange compliance with the proposed rule.").

[42] *See Md. People's Counsel v. FERC*, 761 F.2d 768, 779 (D.C. Cir. 1985) (noting that an agency must demonstrate under the APA that the rule establishes appropriate standards that will actually do "more good than harm").

based pricing the exchange offers.[43] The Commission states that the purpose of this requirement is to "help ensure that the information is available in a timely manner for the Commission and the public's consideration after an exchange implements a new pricing change to show the impact of the pricing change during the first month that it was billed to members" and to "allow time for the Commission and the public to review this data before the expiration of the period within which the Commission is able to summarily temporarily suspend a proposed rule change."[44]

This is problematic for a variety of reasons. Most fundamentally, it is unclear why the Commission would need this information and what "impact" the Commission would be assessing. When discussing this disclosure, the Commission contends that the agency needs this information to help it assess whether to temporarily suspend a proposed rule change.[45] But the Commission can only temporarily suspend a rule change in the first 60 days after filing. How is the Commission supposed to understand whether the fee change is consistent with the rule filing given *at most* only one full month of such required disclosure? Fee changes may not impact changes to order routing for several months or longer, so the idea that the Commission could make determinations about the effectiveness and impact of these changes in such a short time frame belies the way volume-based pricing works. In addition, this retrospective review of fee filings is inconsistent with how the Commission has historically approached fee filing suspensions.

V. The Proposal Fails to Consider Interconnections and Cumulative Effects of Different Proposals, Laws and Regulations

In the past 13 months, the Commission has issued a slate of other proposals that seek to make fundamental changes to equity market structure and to alter the regulatory requirements and competitive landscape in which exchanges and other market centers operate. The Commission has not provided any meaningful analysis or consideration of the expected effects of the Proposal at hand and its interactions with, and cumulative effects created by, these other proposals.

Most glaringly, one of the Commission's December 2022 proposals included a proposition to tweak exchanges' use of volume-based pricing tiers by requiring exchanges to inform customers which fee tier they are in at the time of execution instead of at the end of the month.[46] Notably, the Commission did not suggest in this 2022 proposal that volume-based pricing tiers should be banned; instead, it embraced them, reasoning that letting customers know what volume tier they would receive at the time of

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43 Proposing Release at 76293.

44 *Id.*

45 *Id.*

46 Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, Exchange Act Release No. 96,494, 88 FR 80266, 80293 (Dec. 29, 2022).

execution "would have several benefits."[47] One of the purported benefits the Commission identified was that requiring such transparency about volume tiers at the start of the month would lead to more broker-dealers "pass[ing] along such fees/rebates to their customers,"[48]—meaning that the Commission was effectively advocating for a broader impact of specifically agency-related tiers. The Commission has now directly contradicted that 2022 proposal with the present Proposal, which would explicitly ban volume-based pricing for agency-related trading, and has failed to include any acknowledgement, let alone rationalization, of this contradiction.

As another example, one of the main concerns that the Commission identifies as a basis for the Proposal is that "volume-based exchange transaction pricing exacerbates a conflict of interest between the member and its customer."[49] As context, broker-dealers have a legal duty to seek best execution for customer orders. This is established through common law and anti-fraud obligations, as well as under FINRA and other self-regulatory organization rules. On top of that, in December 2022, the Commission proposed its own broker-dealer best execution rule ("Regulation Best Execution"),[50] which would impose its own comprehensive and detailed best execution requirements on broker-dealers. The Proposal fails to explain why one of its core justifications—potential broker-dealer conflicts of interest and alleged jeopardization of best execution—is not otherwise addressed by long-standing best execution obligations and the Commission's own proposed Regulation Best Execution.

Additionally, under another of the Commission's December 2022 proposed rules, minimum pricing increments would be established and access fee caps would be reduced.[51] These are significant changes that, if finalized, would directly interplay with volume-based pricing—but nowhere does the Commission acknowledge their interconnectedness.

Similarly, the Commission does not discuss how its other proposals and existing rules would mitigate or address the supposed harms the Proposal states "may" be occurring, nor does it explain why the only way to address them is through the requirements mandated by the Proposal. For example, the Commission states that a purported

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47 *Id.* Among the benefits the Commission identified are "reduc[ing] order routing incentives that are based on achieving a threshold in order to gain a specific fee or rebate," "facilitat[ing] a broker-dealer's ability to pass through the fee/rebate associated with a transaction because it would know at the time of the transaction the amount of the fee/rebate that is applicable to each execution," and "provid[ing] more transparency into whether a broker-dealer may be routing to certain venues based on the fee/rebate that venue assesses." *Id.*

48 Proposing Release at 76287.

49 *Id.* at 76286.

50 *See* Regulation Best Execution, Exchange Act Release No. 96,496, 88 FR 5440 (Jan. 27, 2023).

51 *See* Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, Exchange Act Release No. 96,494, 88 FR 80266, 80270 (Dec. 29, 2022).

problem the Proposal is meant to solve is conflicts of interest in the context of routing orders.[52] But the Commission does not analyze or explain how its changes to disclosure obligations under Rule 606—which provides information for customers on how to audit routing decisions—are not enough to mitigate the purported occurrence of conflicted routing that harms customers.[53] Nor does the Commission discuss how disclosure obligations proposed in December 2022 under Rule 605—which covers execution quality reporting for covered broker-dealers—would interplay with the Proposal.[54] And, perhaps most egregiously, the Commission does not acknowledge that the Consolidated Audit Trail ("CAT"), which market participants have spent nearly a decade and hundreds of millions of dollars developing and implementing, provides a treasure trove of information about broker-dealers' routing decisions, which the Commission already has at its disposal to study and analyze. At a minimum, the Commission should instead account for the data these sources will provide and then review the data when it becomes available to see if the theoretical harm actually occurs. The Commission's discussion on how trading will occur if the Proposal was finalized is speculative at best, particularly because it does not contemplate how it would interact with previously proposed initiatives to affect the market.[55]

VI. The Proposal Fails to Satisfy Other Required Rulemaking Requirements and Burdens

The Commission has not met its burden under Exchange Act Section 3(f) to analyze whether, and ultimately demonstrate that, the proposed rule (1) is necessary or appropriate in the public interest and (2) promotes efficiency, competition and capital formation.[56]

Exchange Act Section 3(f) instructs that whenever the Commission is engaged in a rulemaking (as it is here), it is required to consider or determine whether an action is necessary or appropriate in the public interest. The Commission shall also consider, in addition to the protection of investors, *whether the action will promote efficiency, competition and capital formation*.[57] Here, the Commission's analysis of these factors and standards is woefully incomplete. Nowhere does the Commission provide hard data of any harm occurring—instead it relies on an assumption that "[t]he same forces" that

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[52] Proposing Release at 76288 ("Accordingly, the economic incentive presented by tiered exchange transaction pricing may affect members' order routing decisions, exacerbating a conflict of interest that can potentially harm investors with inferior executions when members route customer orders to exchanges.").

[53] *See* Disclosure of Order Handling Information, Exchange Act Release No. 84,528, 83 FR 58338, 58339 (Nov. 19, 2018).

[54] *See* Disclosure of Order Execution Information, Exchange Act Release No. 96,493, 88 FR 3786, 3795 (Jan. 20, 2023).

[55] For example, the Commission largely cites trading data from January 2023. *See, e.g.*, Proposing Release at 76301.

[56] 15 U.S.C. § 78c(f).

[57] *Id.*

apply in economic literature theory apply to the complicated market dynamics of exchange pricing.[58] The relevance of these theories—which are based in part on academic studies assessing video rental and cable television markets—is suspect at best when applied to an industry as distinct as exchanges, which are subject to significant and bespoke regulatory requirements (*e.g.*, the Order Protection Rule) that impact competition.

The Commission's economic analysis is also remarkable in its deficiency because it dramatically under-utilizes CAT data. That is, after repeatedly expanding the functionality requirements for the CAT, which the exchanges have shouldered and paid for, the Commission eschews all but the most elementary CAT data as a resource in its analysis. If the Commission's hypothesis that exchanges' use of volume-based pricing really is impeding competition, CAT data should be able to provide concrete evidence of it. The Proposal's failure to include real-world evidence of harm from the CAT strongly suggests that such evidence does not exist.

Furthermore, when applying this economic theory to hard numbers, the Commission consistently uses data from a *single* point in time, January 2023. For example, the Commission displays market share of trading volume for each exchange while also denoting which fee structure the exchange follows (*e.g.*, maker-taker, flat, inverted, free) as of January 2023 to conclude that the correlation between the two suggests that a "maker-taker transaction pricing model and higher rebates play an important role in attracting competitively priced quotes and capturing market share."[59] Even putting aside the adage that "correlation does not equal causation," this is problematic because market share between exchanges is highly dynamic. If the Commission is going to use market share as its lodestar for an economic analysis it defies reason why it chose one single month's data as its metric. The issue of using only data from January 2023 is further compounded by the fact that, as discussed above, in December 2022 the Commission proposed a series of market-altering rules that have the potential to dramatically minimize the relevance of market share figures from before those proposals go into effect, when the Proposal itself would likely go into effect after those other rules are effective.

The Proposal's conclusions are undermined merely by looking at the subsequent months' data. As only one example, in the month the Proposal considers, Investors Exchange ("IEX") did not offer any rebates as part of its transaction pricing and had just over 4% of the market share for on-exchange trading. IEX's portion of on-exchange trading averaged at 3.97% for the period of January to August 2023. Then, in September 2023, IEX added rebates to its transaction pricing, effectively changing its fee scheduled for displayed liquidity to "maker-taker" from "flat." If offering rebates affects market share in the way the Proposal assumes, one would expect to see a material change in IEX's on-exchange market share after its introduction of rebates, but, to the contrary, its on-exchange market share barely budged for the rest of the year.

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[58] Proposing Release at 76305.

[59] *Id.* at 76302; *see also id.* at 76320 ("Assuming that both volume and average net captures remain the same as those of January 2023, this would translate to a combined overall decrease of $32,720,244 in net transaction fee revenue across the 5 venues.").

IEX's share of exchange trading share for the month of November 2023 was 3.99%, effectively the same share it had before it introduced its rebates.[60]

Similarly, contrary to the Commission's assumption in the Proposal, non-maker-taker exchanges are often among the top exchanges for trading, when examined on a security-by-security basis. For each month of 2023, NYSE analyzed the proportion of securities for which a non-maker-taker exchange was among the top three exchanges on which the security was traded. The results are striking, showing that for each month of 2023, between 35% and 39% of symbols had a non-maker-taker exchange among the top three exchanges on which the security was traded (excluding the security's primary exchange).[61] Given that the Proposal identifies nine maker-taker exchanges, these results mean that for more than one third of all securities, more trading is done on a non-maker-taker exchange than on the majority of maker-taker exchanges. This finding calls into serious question the Proposal's conclusion that maker-taker exchanges offering volume-based rebates is the key driver of on-exchange market share.

Additionally, the Proposal's economic analysis leaves out assessments of how the ban will impact major participants.

- The Proposal does not contain an adequate discussion of the harm caused by the unequal application of the ban to exchanges versus off-exchange venues, or explain why it would promote efficiency, competition and capital formation for competition between exchanges and off-exchange venues to be heavily tilted in favor of off-exchange venues that can continue to offer volume-based discounts (in addition to payment for order flow).

- The Proposal does not acknowledge, let alone address, the effect that it would have in strengthening the largest broker-dealers, whose trading strategies would face less competition from smaller firms currently using sponsored access.[62]

- The Proposal provides no discussion of the harms that will result to investors due to the lack of transparency and worse price discovery on these venues.

- The Proposal also includes no discussion of the impact to issuers that will face higher costs to raise capital due to wider spreads and reduced on-exchange liquidity. While the Proposal makes a passing reference to how its changes may cause wider spreads, it provides no suggestion of why a reduction in speculative harms will outweigh such costs.

The Commission has also not conducted an adequate analysis of the impact of the Proposal on small entities. The Regulatory Flexibility Act ("RFA") requires the Commission to include an examination of a proposed rule's impacts on small entities, unless "the [Commission] certifies that the rule will not, if promulgated, have a significant

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[60] *See* NYSE Daily TAQ data.

[61] *Id.*

[62] *See supra* discussion in Section I.

economic impact on a substantial number of small entities."[63] The Commission baldly asserts that "[t]he proposed rule would apply only to national securities exchanges registered with the Commission that trade NMS stocks" and because such exchanges are not "small business[es]," no RFA analysis is needed.[64] However, the Commission acts inconsistently with the RFA's mandate, which requires the agency to describe the impact of the proposed rule on small entities "subject to the proposed regulation—that is, those small entities to which the proposed rule will apply."[65] At a minimum, a significant number of member firms that are "small entities" will be "directly . . . affected by and regulated by" the Proposal, yet the Commission's certification does not account for these entities.[66] For example, under the Proposal, an exchange must "have a rule to require *its members* to engage in practices that facilitate the exchange's ability to comply with the prohibition on volume-based exchange transaction pricing in connection with the execution of agency-related volume."[67] This represents an explicit and direct compliance burden on these entities. The Commission's failure to conduct an adequate RFA analysis is particularly egregious considering that the Commission's primary purpose in proposing the Proposal is to address purported harms carried out by *non-exchange* participants—broker-dealers—and specifically, the purported harm caused to *lower-volume* broker-dealers.

VII. The Proposal Fails to Adhere to SEC Staff Rulemaking Guidance

Guidance published by the SEC's Office of the General Counsel and the Division of Risk, Strategy, and Financial Innovation (the predecessor to the SEC's Division of Economic and Risk Analysis) states that "[a]s a general matter, every economic analysis in SEC rulemakings should include" various elements, including: "the definition of a baseline against which to measure the likely economic consequences of the proposed regulation;" "the identification of alternative regulatory approaches;" and "an evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis."[68]

As discussed above, because the Commission (a) has not done an appropriate analysis of the baseline or an evaluation of the benefits and costs of the Proposal and (b) does not even know if transaction incentives are distributed to clients, the Commission has not followed its own guidance. Furthermore, the Commission has delegated its own responsibility onto the public and market participants with respect to fact finding and delineating how the markets work, and therefore flipped its own burden of proof into an

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63 5 U.S.C. § 605(b).

64 Proposing Release at 76338.

65 *Aeronautical Repair Station Ass'n, Inc. v. FAA*, 494 F.3d 161, 176 (D.C. Cir. 2007) (internal quotation marks and citations omitted); 5 U.S.C. § 603(a).

66 *Aeronautical Repair Station Ass'n, Inc.*, 494 F.3d at 177.

67 Proposing Release at 76292 (emphasis added).

68 Division of Risk, Strategy, and Financial Innovation and Office of the General Counsel, *Current Guidance on Economic Analysis in SEC Rulemakings*, SEC (Mar. 16, 2012), https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

obligation for the public to refute its suppositions and theories. Commission rulemaking that is "unsupported by substantial evidence" constitutes an unlawful agency action.[69]

VIII. The Proposal Fails to Adequately Consider Reasonable—and Constructive—Alternatives

As explained above, the Proposal's lack of clear rationale and analytical rigor indicate that the Commission's thinking on the broader topic—and whether or not there is a regulatory issue that needs to be addressed—is currently too preliminary to justify a rulemaking proposal. The Commission's preliminary thinking and tentative justifications for its Proposal also make it impossible for the Commission to adequately evaluate alternative approaches: If the Commission is unsure what problem needs to be addressed, then how can it evaluate regulatory approaches and ultimately craft an appropriately tailored response?

One of the consequences of this failure is that the alternative regulatory approaches that the Commission has discussed in the Proposal all assume the same speculative predicates that underpin the Proposal—namely, that there may be a harm caused by exchanges' offering of volume-based transaction pricing in connection with agency-related orders. The Proposal's "Alternative 1" (to ban volume-based pricing for all orders) and "Alternative 2" (to ban volume-based pricing for all orders except registered market makers) simply expand the scope of the ban that the Proposal would establish.[70]

Here, a more appropriate "reasonable alternative" would be for the Commission to step back and better assess whether there is actually a problem that requires regulating. If the Commission believes that the topic of volume-based pricing arrangements warrants further review and consideration, then it is essential that the agency take the time to systematically collect information and perspectives in order to better inform its own understanding and views on the topic before advancing a specific proposal. In the past, the Commission has approached such questions by (1) convening public roundtables, (2) engaging with investors, issuers and other market participants through bilateral information gathering meetings, (3) consulting with other public sector colleagues with relevant expertise and academic experts, (4) consulting with the Commission's advisory committees, (5) developing and releasing for public comment Commission staff studies and (6) issuing concept releases. Here, the Commission skipped all of those fact-gathering steps and jumped straight to an imprudent and unsupported Proposal to regulate a "problem" that it is not sure exists.

Moreover, the Commission's eagerness to regulate in this area flies in the face of the recommendations of a fact-finding body that it *did* convene in 2020 to study the issue:

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69 *Susquehanna Int'l Grp., LLP v. SEC*, 866 F. 3d 442, 445 (D.C. Cir. 2017) (quoting 5. U.S.C. § 706(2)(E)).

70 Proposing Release at 76329, 76331.

the Market Structure Subcommittee of the Commission's Investor Advisory Committee.[71] As Commissioner Peirce pointed out in her dissent to the Proposal:

> We eschewed a more moderate approach, such as providing greater transparency about volume-based pricing tiers as the Investor Advisory Committee recommended in 2020. We need more evidence before taking the extreme step of imposing an outright ban on a particular approach to pricing. An unsubstantiated *fear* that there *could* be problems does not justify adding an onerous and potentially ineffective rule to an already over-prescriptive equity market-structure ruleset.[72]

The issues and dynamics associated with this rulemaking are too complex for the Commission to advance such a significant and consequential change without a more developed understanding of the topic. The Commission must invest the time to systematically identify what, if any, regulatory concerns exist, and then analyze and evaluate the range of potential regulatory responses to address those concerns in a targeted manner.[73] This must be done in a deliberate, careful and even-handed manner. Only then should the Commission proceed with a rulemaking proposal.

For all the foregoing reasons, the Commission should withdraw the Proposal.

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[71] *Recommendation of the SEC Investor Advisory Committee Regarding Exchange Rebate Tier Disclosure*, SEC (Jan. 24, 2020), https://www.sec.gov/spotlight/investor-advisory-committee-2012/exchange-rebate-tier-disclosure.pdf.

[72] Commissioner Hester M. Peirce, *Fears for Tiers: Statement on Proposed Volume-Based Exchange Transaction Pricing for NMS Stocks*, SEC (Oct. 18, 2023), https://www.sec.gov/news/statement/statement-peirce-proposed-volume-based-exchange-transaction-pricing-nms-10-18-2023. The Proposal's "Alternative 3" (to proceed with transparency provisions for all orders without tiers prohibition), *see* Proposing Release at 76333, comes the closest to the Investor Advisory Committee's 2020 recommendation that the Commission consider a series of disclosure-focused policy approaches to better understand exchange pricing and rebate practices, *see Recommendation of the SEC Investor Advisory Committee Regarding Exchange Rebate Tier Disclosure*, SEC (Jan. 24, 2020), https://www.sec.gov/spotlight/investor-advisory-committee-2012/exchange-rebate-tier-disclosure.pdf.

[73] The Commission could also explore how its own fee mandates may hinder its stated objectives under the Proposal. For example, under Section 31 of the Exchange Act, national securities exchanges must pay transaction fees to the SEC based on the volume of securities that are sold on their markets, a fee which is then passed through to broker-dealers who conduct these transactions. *See* 15 U.S.C. § 78ee; 17 C.F.R. § 240.31. The Commission could explore how these fees may have a disparate impact on smaller-volume broker-dealers.

NYSE Group appreciates the opportunity to provide our comments to the Commission regarding the Proposal and we are available to meet with the Commission or its staff to discuss our comments.

Respectfully submitted,

Hope M. Jarkowski
General Counsel
NYSE Group, Inc.

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