Investors' Exchange LLC
3 World Trade Center, 58th Floor
New York, New York 10007
1 646 343 2000
iexexchange.io

iex exchange | iex

January 5, 2024

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

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

Dear Ms. Countryman:

Investors Exchange LLC ("IEX") respectfully submits this letter in response to the Commission's proposal ("Proposal") to adopt new Rule 6b-1 under the Securities Exchange Act of 1934 ("Exchange Act"). Rule 6b-1 would impose restrictions on the use of volume-based transaction fees, rebates, or other incentives by national securities exchanges in connection with the execution of certain orders in NMS stocks.[1] For the reasons detailed below, IEX supports prohibiting the use of volume-based pricing ("tiered pricing") in connection with agency and riskless principal orders, but we believe this prohibition should be extended to encompass the execution of principal orders.

Introduction and Summary

In brief, the Proposal includes the following:

- It would prohibit national securities exchanges from using tiered pricing in connection with the execution of agency and riskless principal ("agency-related") orders by exchange members in NMS stocks.
- It would require exchanges that use tiered pricing with respect to proprietary orders by members in NMS stocks to provide public disclosure each month of certain information with respect to each pricing tier, including the number of members that qualify for each tier.
- Exchanges using tiered pricing for principal orders would also need to have rules requiring members to take measures to facilitate the exchange's ability to comply with the tiered pricing prohibition for agency-related orders. These exchanges would also need to maintain policies and procedures to detect and deter members from evading that prohibition.

The following summarizes IEX's views on the Proposal, as detailed further below:

There is compelling evidence that the use of tiered pricing by national securities exchanges conflicts with basic Exchange Act standards. These include requirements that exchange rules provide for the equitable allocation of exchange fees, avoid unfair discrimination among members and other stakeholders, and prohibit any undue burden on competition, among other

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[1] *See* Securities Exchange Act Release No. 34-98766, 88 FRR 76282 (November 6, 2023) ("Proposing Release"), [Proposed Rule: Volume-Based Exchange Transaction Pricing for NMS Stocks (sec.gov)](). The term "NMS stock" is defined in Rule 600(b)(55) of Regulation NMS.

provisions. Because tiered pricing so clearly and directly conflicts with these requirements, action by the Commission is called for.

The Commission has ample legal authority through its oversight authority of exchanges as self-regulatory organizations to prohibit the use of tiered pricing.

The Commission should apply this prohibition to both agency and principal orders. If it determines to allow an exception for principal orders, that exception should be limited to registered market makers that are subject to specified market quality requirements.

SEC Authority and Oversight

The Commission's oversight of national securities exchanges is at the heart of the reason for the Exchange Act. Since its enactment, the seminal statement of the reason for the Exchange Act is that transactions in securities on exchanges are "affected with a national public interest."[2] The Exchange Act recognizes the importance of exchanges to the equity markets and the overall functioning of the U.S. economy.

As self-regulatory organizations ("SROs"), exchanges are subject to comprehensive regulation and oversight over all aspects of their operation, including the fees they charge to their members and others. The Exchange Act allows the SEC to delegate some of the function of regulating the markets to SROs, but it requires that in turn they be subordinate to the SEC in exercising their functions. This close oversight and subordination is necessary to make sure that exchanges and other SROs do not abuse their special status to favor their own interests, to the detriment of the public interest.[3] Furthermore, this system of closely supervised delegation assures that the exercise of SRO authority does not amount to an impermissible delegation of government authority to private companies under the Constitution.[4]

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[2] Securities Exchange Act of 1934, Section 2, 78b, COMPS-1885.pdf (govinfo.gov)

[3] *See, e.g.,* Marianne K. Smythe, *Government Supervised Self-Regulation in the Securities Industry and the Antitrust Laws: Suggestions for an Accommodation*, 62 N.C. L. Rev. 475, 476 (1984) (explaining that "[s]elf-regulatory organizations may be less interested in regulation designed to protect the general public than in regulation crafted to restrict competition and reinforce the dominance of the powerful members of the regulated group."); *see also* Concept Release Concerning Self-Regulation, 69 Fed. Reg. 71,256, 71,258 (Dec. 8, 2004) ("SEC Concept Release") 71258 (explaining that past studies have concluded that "SROs have a natural tendency to protect member firms and that SRO regulatory operations appear to falter without the 'pointed stimuli' of vigilant Commission oversight."); Onnig H. Dombalagian, *Demythologizing the Stock Exchange: Reconciling Self Regulation and the National Market System*, 39 U. Rich. L. Rev. 1069, 1134 (2005) (explaining that "Congress and the Commission . . . sought to ensure that self-regulatory objectives would not be compromised for the sake of commercial advancement.").

[4] *See, e.g.*, *Nat'l Horsemen's Benevolent & Protective Ass'n v. Black*, 53 F.4th 869, 872 (5th Cir. 2022) (striking down the private-agency construct as unconstitutional and giving the example of the SRO's fee assessment methodology rules, whereby the Court held that the agency was too limited in its ability to modify fee rules or exercise rulemaking power based on policy considerations, effectively excluding the agency from second-guessing the SRO's policy choices, and thereby violating the private non-delegation doctrine); *see also* Alpine Securities Corporation v. FINRA, Brief for Intervenor United States of America (October 27, 2023) (explaining that the SRO as a private entity must "function subordinately" to the SEC in a manner that allows the SEC to "hold the line against overreaching" and that the SEC is given "pervasive supervisory authority" and "must be empowered to provide a 'check' against private self-interest and 'protect the public good.'").

Consistent with this scheme, the Commission has broad authority to add to, modify, or delete exchange rules. This substantial discretion to the Commission is applied broadly and includes the independent and ongoing assessment of, among other aspects of exchanges' business, all fee schedules or policies relating to fees, dues, and other charges.[5] Therefore, unlike ordinary private companies, exchanges are not free to set fees as they see fit but are subject to the Commission's oversight authority and the requirement that they demonstrate their fee structures meet the requirements of the Exchange Act.[6]

There are multiple individual Exchange Act provisions that are relevant to exchange transaction fees and justify Commission rulemaking in this area. These include the provisions that rules of registered exchanges meet all of the following standards:

- SRO rules must provide for the **equitable allocation of reasonable dues, fees, and other charges** among its members and others.[7]
- SRO rules must **not be designed to permit unfair discrimination** among brokers and dealers, issuers, and customers.[8]
- SRO rules must **not impose any burden on competition** that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.[9]

Pursuant to well-established precedent, the SRO has the burden to demonstrate that *all* enumerated statutory requirements are met, and the SEC is afforded substantial discretion when independently reviewing SRO rules to make that determination.[10]

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[5] *See, e.g.*, 15 U.S.C. 78s(c).

[6] *See* Roberta S. Karmel & Claire R. Kelly, The Hardening of Soft Law in Securities Regulation, 34 Brook. J. Int'l L. 883, 886 (2009) (explaining Congressional and SEC views that "SROs should not be private clubs, looking out for the interests of their members, but public bodies, looking out for the interests of investors"); *see also* Onnig H. Dombalagian, *Demythologizing the Stock Exchange: Reconciling Self Regulation and the National Market System*, 39 U. Rich. L. Rev. 1069, 1070 (2005) (noting that "the Commission's mandate to create a national market system, adopted within the same [1975] Amendments, proceeded from the premise that monopoly power of the primary stock exchanges should be restrained to promote greater competition among markets").

[7] *See* 15 U.S.C. 78(b)(4).

[8] *See* 15 U.S.C. 78(b)(5).

[9] *See* 15 U.S.C. 78(b)(8); *see* Healthy Markets Association Comment Letter (November 13, 2018) (commenting that "[d]espite the Exchange Act's mandate that exchange fees be reasonable, equitably allocated, not unfairly discriminatory, and not an undue burden on competition, each firm is subject to whatever rate it can convince an exchange (presumably for business reasons) to grant.") srnyse201849-4640899-176435.pdf (sec.gov)

[10] *See* 15 U.S.C. 78s(c). The SEC, by rule, may "abrogate, add to, and delete from" any rule of a self-regulatory organization as the SEC "deems necessary or appropriate" in order to ensure "the fair administration of the self-regulatory organization," "to conform its rules to" the Exchange Act or the SEC's rules, or "otherwise in furtherance of the purposes of " the Exchange Act; *see also, e.g.*, *Alliance for Fair Board Recruitment v SEC*, No. 21-60626, (5th Cir. Oct. 18, 2023) (discussing the numerous statutory parameters required of exchange rules, including among others, that a rule must not be "designed to permit unfair discrimination between customers, issuers, brokers, or dealers" or "must not "impose any burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange

In addition, the Commission has comprehensive authority to write rules to govern equity markets under the amendments that adopted Section 11A of the Exchange Act (the "1975 Amendments"). Under those amendments, Congress mandated and directed the SEC to "facilitate the establishment of a national market system for securities", also known as the NMS. Section 11A sets out specific objectives that the SEC is directed to meet in adopting rules to establish the NMS, including:

- **Economically efficient** execution of securities transactions;
- **Fair competition** among brokers and dealers and among exchange markets;
- The availability to brokers, dealers, and investors of **information with respect to quotations** for and transactions in securities.
- The practicability of **brokers executing investors' orders in the best market**.[11]

As detailed below, action by the SEC to restrict the use of tiered pricing is supported under *each* of these provisions.

Further, restrictions on exchange transaction pricing are especially important because Regulation NMS Rule 611 gives displayed quotations on exchanges special status as protected quotations, requiring that orders be routed first to access exchange quotes before being executed at a worse price. As a result of this preference, exchanges possess significant market power in setting prices for both providing and accessing displayed quotes and allocating the economic costs and benefits of trading in NMS securities among market participants. In fact, in adopting the 1975 Amendments, Congress expressly sought to guard against the risk that exchanges, as government-protected licensees, could exert inordinate power over the fees required to participate in the equity markets.[12] Rule 611 gives even greater weight to the value of this exclusive status and reinforces the need for Commission oversight of exchange pricing practices.

The Need for Market Reform

As detailed below and in the Proposing Release, there is clear and compelling evidence that the tiered pricing system impacts and in many ways conflicts with each of the exchange standards and NMS statutory goals cited above:

- Tiered pricing conflicts with market efficiency by substantially increasing the complexity and opacity of exchange pricing and routing decisions. Similarly, it obfuscates transparency about quotations in securities because it causes quoted prices to significantly depart from the true economic costs reflected in those quotations. And

Act]," further explaining the SEC's obligation "to look beyond an exchange's self-serving statements" in making an independent review of SRO rules, and upholding an APA challenge because "[t]he making of policy decisions and the resolution of conflicting evidence" is the SEC's job, not the court's").

[11] 15 U.S.C. 78k-1(a)(1)(C). *See also* 15 U.S. Code § 78f(e)(2) ("Notwithstanding the provisions of section 78s(c) of this title, the Commission, by rule, may abrogate any exchange rule which imposes a schedule or fixes rates of commissions, allowances, discounts, or other fees, if the Commission determines that such schedule or fixed rates are no longer reasonable, in the public interest, or necessary to accomplish the purposes of this chapter").

[12] *See* Intermarket Competition and Monopoly Power in the U.S. Stock Markets, 1 BROOK. J. CORP. & COM. L. 273, 278 (2007).

because the economics differ depending on which firm is posting or accessing a quotation, the same quote can reflect multiple versions of the price to buy or sell the same stock at the same moment.

- Far from an "equitable distribution" of reasonable fees, tiered pricing results in an extremely skewed distribution of fee benefits and burdens in favor of a small number of firms at the expense of the many, considered on both an aggregate and per share basis.

- Tiered pricing unfairly discriminates against smaller and mid-tier brokers that have no ability to ever qualify for the per share pricing benefits available to the few highest-volume members.

- Tiered pricing substantially hinders competition for agency orders, in that lower-volume firms are driven to route orders through their competitors, and it helps to concentrate principal trading volume into the hands of an increasingly smaller pool of firms by providing a substantial subsidy to that small pool relative to their competitors.

- Tiered pricing substantially undermines and distorts competition among exchanges by reducing the ability of exchanges to compete for orders based on market innovation, service and execution quality rather than based on individualized price schedules.

- Tiered pricing runs counter to the goal of best execution because brokers have a strong incentive to route orders based on heavily tiered rebate payouts, which are generally not able to be passed on to clients, rather than where the clients can receive the best execution.

Opacity/Complexity

Tiered pricing has created an absurd level of complexity in terms of the number of tiers and the factors that are built into each one. The extent of this complexity is revealed in a series of reports by RBC Capital Markets ("RBC"), which first published a report in 2016 summarizing the number of "pricing paths" affecting the fee or rebate for any given transaction, across all exchanges, and the number of variables that affect individual tier rates. RBC has since updated its initial report in 2018 and did so again in November of 2023.[13] In the 2018 report, RBC concluded there were at least 1,023 pricing paths, which was an increase of nearly 22% from the number that it identified in 2016. It found that these paths were determined by at least 3,762 pricing variables. In its latest update, it determined the number of pricing paths had ballooned to 1,314, another increase of 28%, and that these were influenced by 4,846 variables.[14]

As suggested by these figures, individual tier criteria routinely change, which increases the cost for member firms to update their systems to take account of them. The opacity and complexity are exacerbated because tiered pricing discounts and rebate amounts per firm are typically not known until the end of each month. Because this system is so abstruse, the reality is that only

[13] *See* RBC Cap. Markets, *Complexity of Exchange Pricing and Corresponding Challenges to Transparency and Routing*, Nov. 2023 ("RBC Study"), avail. at RBC Insight (rbcinsightresearch.com).

[14] *See* RBC Study (conducting a comprehensive study that analyzes pricing data across exchanges and concluding that the "bespoke nature of pricing paths on exchanges have effects that are arguably problematic for both institutional and retail clients, as well as for the orderly functioning of the U.S. equity markets as a whole.").

the small number of firms designed to benefit from individual tiers are positioned to track and continually adapt to this kaleidoscope of increasingly complex and "bespoke" tiers.

This extreme high-complexity, low-transparency system impedes overall market efficiency and increases market-wide costs because it hinders the ability of even professional market participants, let alone investors, to assure that orders are routed in the most efficient way.

Exchange rebate tiers have become so extraordinarily complex that Nasdaq, in filing a restatement of its fees in 2022, claimed to have rendered its fee scheme "shorter" and "more readable," yet submitted fee schedules that stretched to more than 82 pages of charts.[15] Most of the pricing tiers are based on multiple factors and are so detailed and highly tailored that on their face they cannot be characterized as non-discriminatory or "equitably allocated". These are just a few examples:

- Rebate of 30.5 mils (larger than the maximum take fee) to member (i) with shares of liquidity provided in all securities through one or more of its Nasdaq Market Center MPIDs that represent 1.20% or more of Consolidated Volume; (ii) executes 0.40% or more of Consolidated Volume through providing midpoint orders and through M-ELO and (iii) removes at least 1.45% of Consolidated Volume;
- Rebate of 30 mils to member (i) with shares of liquidity provided in all securities through one or more of its Nasdaq Market Center MPIDs that represent 0.875% or more of Consolidated Volume; (ii) executes 0.25% or more of Consolidated Volume through providing midpoint orders and through M-ELO; and (iii) removes at least 1.35% of Consolidated Volume; and
- Rebate of 28 mils to member (i) with shares of liquidity provided in all securities through one or more of its Nasdaq Market Center MPIDs representing at least 0.375% of Consolidated Volume; (ii) that executes an ADV of at least 500,000 shares of M-ELO Orders during the month; and (iii) that increases the extent of its ADV of M-ELO Orders in all securities by 100% or more during the month relative to the month of June 2021.[16]

As these examples illustrate, the criteria often combine extremely high-volume thresholds with additional volume criteria based on different types of order flow for both providing and taking liquidity. The specificity of those requirements and seeming arbitrariness of reference dates supports the assumption that individual tier criteria are not just exclusionary but targeted to benefit individual firms.

<u>Impact on Broker-Dealers</u>

Tiered pricing impacts broker dealers in significant ways because of how it affects net profitability for both agency and principal-based firms and the ability of individual firms to trade on an exchange at a significant scale. In a real sense, the tier system is a clear case of exchanges picking "winners and losers". A small subset of larger brokers who can satisfy bespoke tier pricing levels have dramatically different costs than smaller brokers to trade on the same exchange using the same types of orders for the exact same securities. This conflicts with statutory standards relating to (i) equitable allocation of fees, (ii) unfair discrimination, and (iii)

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[15] *See* Securities Exchange Act Release No. 95091, 87 FR 36562 (June 17, 2022) ("Nasdaq 2022 Fee Filing").

[16] *See* https://listingcenter.nasdaq.com/assets/rulebook/nasdaq/filings/SR-NASDAQ-2022-036.pdf.

fair competition. To understand these points, it is important to understand how tiered pricing affects the economics of exchange trading.

Effect of Tiering on Trading Economics

The tier system substantially affects the economics and profitability of all firms that trade on exchange as principal and/or agent. It impacts both exchange members that have the ability to access exchanges directly as well as other broker-dealers that must rely on members to access those markets to receive competitive prices.

The impact of tiered pricing to trading economics can be viewed in per share and aggregate terms. Based on public data, the top adding rebate tier for displayed liquidity on large maker-taker exchanges ranged from 30.5 to 36 mils per share (still higher payouts are often available for particular types of order flow or classes of security) as of December 2023. Thus, on most of these exchanges, the payout for the top displayed "adding" rate exceeded one-third of the minimum one cent tick size. Similarly, the top rate is very large in relation to broker commissions. As estimated in a recent Bloomberg Intelligence report, commissions for algorithmic trading for institutional order flow in 2020 were generally in the range of 60 mils.[17] Further, the difference between the top and base rebate tiers can itself be very significant in relation to spreads and commissions. As of December 2023, the difference between the basic and top rebate tiers for displayed orders (without considering other specialized tiers) ranged from 12 to 18 mils.

Further, the fact that the best tier rates exceed the maximum access fees necessarily means that small and medium size brokers are subsidizing the highest volume firms. This is fundamentally different from a business using standard volume discounts to incentivize a higher level of business activity by all its customers.

The economic impact can also be evaluated in terms of the aggregate financial payout to firms that can qualify for the top tiers. IEX has calculated that the payout for making the top basic rebate tier on all the major maker-exchanges, based on the *minimum* volume required to qualify for each such tier, was $443 million as of February 2023.[18]

The significance of even small differences in rebate tier payouts to broker-dealer economics can be seen in the fact that the difference between payout for the top and next highest basic displayed adding tiers is usually no more than one mil per share, while the additional volume needed to quality for the higher payout is extremely large, often an amount that exceeds the volume of most alternative trading systems ("ATSs") and many exchanges.[19] The contrast

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[17] *See* IEX Comment Letter re: Release No. 34-96494; Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, (Oct. 19, 2023), at 7, s73022-276579-672162.pdf (sec.gov); *see also* https://assets.bbhub.io/professional/sites/10/2021_02-Market-Structure-Buyside-Survey-US.pdf.

[18] *See* IEX Comment Letter re: Release No. 34-96494; Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, at 25 (March 20, 2023), s73022-20160364-328968.pdf (sec.gov).

[19] *See* Letter from John Ramsay, Chief Market Policy Officer, IEX, to Vanessa Countryman, Secretary, SEC, dated September 20, 2023, avail. at https://www.sec.gov/comments/s7-30-22/s73022-262059-619382.pdf, at 2-3.

between the gap in payout and volume requirements suggests how valuable incremental tier payments are and, in turn, the impact on competition they have.

These effects on individual firms depend heavily on how individual firms trade on exchange and how often they provide rather than take liquidity. As is well understood, the great majority of orders to take liquidity are subject to the maximum take fee. Because institutional investors often must access exchange quotes when they have an immediate need to trade, brokers acting for investors often must pay the maximum permitted access fee, and this customer-directed trading causes them to receive relatively less benefit from rebate tiers.

Inequitable Allocation of Fees and Unfair Discrimination

The Exchange Act requires an "equitable allocation" of reasonable fees and prohibits exchanges from "unfairly discriminating" among their members.[20] By their nature, these are normative standards – they call for the Commission to make value judgments and empower the Commission to exercise discretion. *The question then, is whether the Commission can reasonably conclude that tiered pricing does not "ensure an equitable allocation of fees" or that it "unfairly discriminates" among broker-dealers.*

The evidence in the record suggests it would be hard for the SEC to reach any other conclusion. The nature and extent of the discrimination, and why it is unfair and inequitable, is clear based on how the tiers are constructed, how narrowly targeted they are to benefit a relative few, and how they compare to other types of exchange fees.[21]

As IEX has previously detailed, tiered pricing is generally based on measures of Total Consolidated Volume ("TCV"). This type of volume pricing gives a discount not just for providing more volume, but for the ability to maintain a volume on a particular exchange that is measured as a fraction of all market volume in NMS securities, conducted both on and off exchange. For example, to qualify for the best rebate rate on one exchange, a member's volume on that market would need to equal to 1.5% of all market-wide trading. Using the average daily volume during November 2023, that percentage equates to daily volume of approximately 163 million

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[20] *See, e.g.*, *Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 19(h)(1) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order* (enforcement against NYSE for offering bespoke co-location fees that were the product of discrete negotiations with each customer and that the Commission determined were not equitably allocated among members). New York Stock Exchange LLC, NYSE Arca, Inc., NYSE MKT LLC f/k/a NYSE Amex LLC, and Archipelago Securities, L.L.C.

[21] *See e.g.*, Tomio Geron, Protocol *It's not just Robinhood. Money-hungry stock exchanges are under scrutiny too* (July 30, 2021) Why stock exchange rebates are attracting growing regulatory scrutiny - Protocol (commenting that the intricacies of exchange rebates of modern markets that are largely opaque to people outside the trading world add up to a system that favors "a short roster of very sophisticated practitioners," said Paul Rowady, director of research at Alphacution Research Conservatory); Congressional Letter to the SEC**,** Ted Budd, Ann Wagner and Alex Mooney (Jan. 31, 2020) (commenting that this form of discriminatory pricing runs counter to the tenants of the Exchange Act and significantly weakens competition between large and small brokers); Healthy Markets Association Comment Letter (November 13, 2018) (commenting that "somewhat bizarrely, the exchange seems to argue that the fees are 'equitable' because they 'will encourage the submission of additional liquidity.' How offering an incentive to a small subset of customers is "equitable" for all customers is unexplained.") srnyse201849-4640899-176435.pdf (sec.gov).

shares, an amount that exceeds the entire volume of all but one or two alternative trading systems and many individual exchanges.

The numbers are even more astounding when considering the minimum top-tier volumes across exchanges. IEX has calculated that the volume needed to qualify for the top rebate tiers on all the large maker-taker exchanges would exceed 9% of all exchange volume. During November, this would translate to daily volume of over 551 million shares. Further, as noted above, the dollar value of payouts from the top tiers can easily amount to hundreds of millions of dollars annually for a single firm. Moreover, some pricing paths are so highly specific and customized that it is hard to avoid the conclusion that they in practice are designed to benefit only one or two single members.

By contrast, other exchange fees, including fees for market data products, are generally charged on a subscription basis, according to the number and type of data feeds and other products, e.g., connectivity choices, that are used. No exchange provides discounts for subscription fees of this type tied to trading volume, whether tiered or otherwise, and it is doubtful whether any such discounts could be approved. Further, fees for exchange proprietary market data and connectivity products have increased substantially since the adoption of Regulation NMS, eclipsing the revenue that exchanges earn from net transaction fees.[22]

Many trading firms have repeatedly stressed that they are effectively compelled to subscribe to market data and connectivity products from most exchanges in order to be competitive in posting and accessing liquidity on exchanges. Further, institutional investors are driven to limit the brokers they use to execute their orders to those that have subscribed to these products.[23] The effect of this dichotomy – heavily skewed rebate tier payouts weighted to a small number of firms coupled with increasing subscription costs that are not scaled based on trading volume – is that broker-dealers other than members that qualify for the best rebate tiers bear a disproportionate burden of overall exchange costs. In contrast, a very small number of favored firms, on a net basis, incur substantially reduced costs and can even receive net payments from certain exchanges. One exchange executive famously noted that his exchange provided a check to five of its top trading firms each month, after accounting for costs and payouts from all sources.[24]

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[22] *See,* e.g., Tabb Group Presentation for SEC Market Data Roundtable, 4729-4559257-176198.pdf (sec.gov); Cboe Third Quarter 2023 Earnings Presentation, https://ir.cboe.com/files/doc_financials/2023/q3/3q23-cboe-earnings-slides-final.pdf; Form 10-K for Nasdaq INC filed 02/23/2023

[23] *See* Remarks of Mehmet Kinak, SEC Roundtable on Market Data Product, Market Access Services, and Their Associated Fees, dated October 25, 2018 ("Market Data Roundtable") at 65-66, avail. at https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102518-transcript.pdf.

[24] *See* Proposing Release at n.3, Remarks of Chris Concannon, Market Data Roundtable, at 74-75; *see also SEC Scrutinizes Fairness of Stock Exchange Pricing*, Reuters (Mar. 7, 2019) (discussing that when factoring in rebate payments from the exchanges, five of the top 10 customers at both Nasdaq and Cboe by volume actually receive checks from the exchanges at the end of the month, net of fees, according recent comments by a Cboe executive and a Nasdaq report). https://www.reuters.com/article/us-sec-exchanges-fees-exclusive/exclusive-sec-scrutinizes-fairness-of-stock-exchange-pricing-idUSKCN1QO2CY; Michael J. McGowan, The Rise of Computerized High Frequency Trading: Use and

Given this evidence, the Commission has a more than sufficient basis, exercising its reasonable discretion, to conclude that tiered pricing as practiced today is unfairly discriminatory among exchange members and other broker-dealers and involves fees that are inequitably allocated. Action by the Commission is clearly justified. Having established this point, the only remaining question is whether the action proposed is reasonably designed to address the problem, a question we address further below.

Burden on Competition

As noted above, the Exchange Act directs the Commission to ensure "fair competition" among brokers and dealers in creating the NMS. It also sets a standard that exchange rules may not create any burden on competition "not necessary or appropriate" to advance the purposes of the statute.[25] The legislative history of the 1975 Amendments shows that Congress charged the SEC with promoting competition and preventing SROs from adopting anti-competitive practices.[26] It is worth noting that this standard sets a raised bar in that once a practice is shown to act as a burden on competition, as is the case with pricing tiers, the scrutiny shifts to whether imposing such a burden is necessary or appropriate in furtherance of the purposes of the Exchange Act.

There is clear evidence, both laid out in the Proposing Release and as detailed in this letter, that tiered pricing both acts as a burden on competition and does so in a way that directly contravenes the purposes of the Exchange Act. This is true because it substantially affects the economics of principal and agency trading firms in a way that determines who can compete and the level at which they can compete.[27]

Controversy, 9 *Duke Law & Technology Review* 1-25 (2010) (explaining that "[l]iquidity rebate trading has been scrutinized because it allows rebate traders to basically trade for free by having their commission costs and exchange fees covered by the exchanges and ECNs.").

[25] *See* 15 U.S.C. § 78f(b)(8).

[26] *See* Address by Philip A. Loomis, Jr., Commissioner, SEC, "The Securities Acts Amendments of 1975, Self-Regulation and the National Market System" (November 18, 1975), at 10: "There was not so much a conclusion that the scheme of governmental securities regulation itself suppressed competition but rather than it failed to require competition or to prevent industry organizations from behaving in an anti-competitive way."

[27] *See, e.g.*, Commissioner Caroline Crenshaw, *Statement on Proposals Related to Equity Market Structure* (December 14, 2022) (noting the "problematic model" of complex fee and rebate schedules that have developed, explaining that the uncertainty of brokers not knowing what the fees are until after the months' end has implications for transparency and best execution, and expressing "deep concerns" about the model from a competitive standpoint) https://www.sec.gov/news/statement/crenshaw-insider-trading-20221214-0#_ftn14; Congressional Letter to the SEC, Ted Budd, Ann Wagner and Alex Mooney (Jan. 31, 2020) (commenting that they believe the fee-based incentives substantially disadvantage smaller brokers and reduce competition for order flow in pursuit of best execution); Chester Spatt, *"Is Equity Market Exchange Structure Anti-Competitive?"* (Dec. 28, 2020) (https://www.cmu.edu/tepper/faculty-and-research/assets/docs/anti-competitive-rebates.pdf (former Chief Economist for the SEC explaining that the use of relative volumes in the rebate tiers create barriers to competition for both the exchanges who don't use tiered pricing and non-large brokers that do not receive tiered pricing, and noting concerns as to whether the structure of the pricing tiers imposes an undue burden on competition and is incompatible with the requirements of the Exchange Act).

Most of the costs of principal and agency traders to start operations or increase the extent of their involvement in the equity markets increase with the scope of business conducted but in a way that benefits from economies of scale. They include costs of hardware and software, technology, staff, costs of market data and connectivity products, and similar costs. In contrast, equity trading firms largely earn revenue on a simple per share basis – firms with more order flow and positive revenue per share will profit in relation to the number of orders they receive and execute.

Rebate payouts made on a per share basis therefore affect the ability of firms to recover their costs, and firms that create or handle more order flow obviously will benefit disproportionately more even when rebates are paid on a per share basis. But tiered pricing as practiced today provides a benefit that is much more than linear. Instead, the benefit is amplified based on the factor of the total volume handled during a period by a given firm. And because of the use of TCV tiering, this is based not just on the volume of trading conducted on an exchange, but the volume of trading in relation to all market-wide volume. As detailed above, this system creates a huge divide between firms that receive only the base rebate compared to top rebate rates. But it also distinguishes firms within the top rates, by requiring substantial increases in trading volume in order to receive an additional one mil or even one-half mil benefit. This itself suggests that the tiered pricing treats members disparately and can substantially affect profitability and routing decisions of firms that are able to trade equity securities at significant scale.

There is ample evidence that tiered pricing does in fact act as a substantial burden on competition.

First, as the Commission has noted, many firms that are not able to qualify for tiered pricing benefits are driven to route orders for themselves or for their customers through their own competitors and seek to capture some portion of the financial benefit those competitors receive. A system in which companies are compelled to rely on their competitors to grant them more favorable pricing than they could receive on their own, in order for them to try to compete at a diminished level, is not just evidence of a burden on competition – it is the antithesis of fair competition.

Second, the number, complexity, and granularity of very specific pricing paths strongly suggests that certain pricing benefits are tailor-made for individual firms. This, too, is directly contrary to the concept of "fair competition".

Third, data shows a long-term contraction in the number of competing agency and principal trading firms. The Commission noted a decline of over 20% in the number of broker-dealers between 2015-2022.[28] IEX has also provided data showing the decline in exchange membership over time. From 2012 to 2021, the number of exchange members declined substantially on all large exchanges, including a 69% decline on NYSE Arca and a 44% decline on Nasdaq.[29] Over a longer time frame, the number of competing market makers has also declined – for example, collapsing from 55 competing designated market makers on the NYSE in the late 80s to just three today.[30] Given how significant the difference is in payout rates

[28] Proposing Release, 88 FR at 78613.

[29] *See* https://www.iex.io/article/the-rising-tide-of-broker-costs-and-the-shrinking-pool-of-competitors.
[30] *Id.*

among different firms, and how large those differences are in relation to cost measures like average spread and commissions, it seems obvious that tiered pricing has significantly contributed to this trend.

Fourth, smaller and mid-sized brokerage firms and their representatives have clearly spoken out on this issue, confirming that tiered pricing limits both entry of new competitors and their own ability to compete.[31]

In addition, academic experts have pointed to the anti-competitive aspects of the system, comparing it to competitive restraints in other fields.[32]

Finally, data indicates that rebate tiers have grown progressively more restrictive over time, meaning that the anti-competitive impact has grown more acute. IEX analyzed the TCV percentage required to qualify for the Nasdaq's top basic displayed adding volume tier since 2008. The results are reflected in the following chart[33]:

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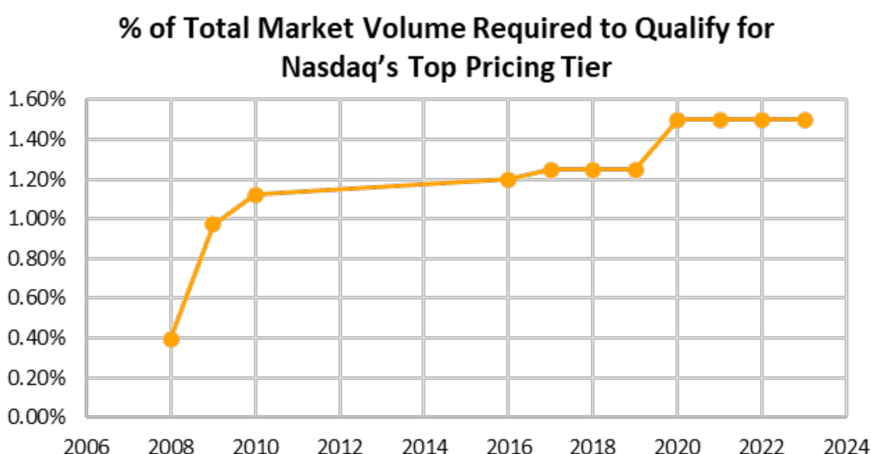
[31] *See, e.g.*, American Securities Association Letter (Mar. 31, 2023) (commenting that the "current tiered rebate pricing scheme imposes a burden on market competition that impacts every other exchange member that cannot trade the volume needed to obtain the highest rebate tiers. Eliminating this discriminatory practice would force exchanges to come up with an alternative pricing method that fairly allocates exchange fees among *all of its members*, as is required by law") (emphasis in original). s73222-20163332-333215.pdf (sec.gov); *see also* Proof Services LLC Letter (3/31/2023) (commenting as an institutional broker that "pricing tiers as currently constituted should be a source of shame for our industry," and explaining that pricing tiers have grown so complex that they have become effectively "bespoke pricing" that undermines faith in the fairness of market access); s73022-20162961-332930.pdf (sec.gov); Citigroup Global Markets Inc. ("CGMI") Letter (3/31/2023) (explaining that "[m]any of CGMI's institutional clients are increasingly measuring their execution costs all-in, inclusive of exchange fees" and viewing rebate exchange tiers as "anti-competitive" that "discourage innovation by not rewarding superior routing strategies and techniques" and "make it more difficult for smaller brokers and new entrants to the market") https://www.sec.gov/comments/s7-29-22/s72922-20162912-332734.pdf; BMO Capital Markets Corp. Letter, March 31, 2023 (commenting that BMO agrees with the Commission's assessment of how existing exchange pricing tier models can "negatively impact market participants behavior" and encouraging the Commission to review and address the issue of "bespoke" pricing tiers prevalent in today's volume tiered pricing models) s73022-20162896-332617.pdf (sec.gov); The Clearpool Group Letter, SEC Roundtable on Market Data and Market Access (Oct. 23, 2018) (independent broker commenting that the tiered pricing structures have created an environment that presents a potential barrier to entry into the markets for many smaller firms and stating that "[s]maller broker-dealers cannot wait for market driven solutions to address concerns raised by the costs of trading and to create a more competitive or equitable environment for market participants, as it is clear that exchanges have little interest in changing the status quo") 4729-4555206-176185.pdf (sec.gov).

[32] *See* Chester Spatt, *"Is Equity Market Exchange Structure Anti-Competitive?"* (Dec. 28, 2020) (using economic principles to identify a variety of ways in which the tiering of equity market rebates reflects anti-competitive practices that provide a mechanism by which exchanges are engaging in price discrimination) https://www.cmu.edu/tepper/faculty-and-research/assets/docs/anti-competitive-rebates.pdf; *see also* Chester Spatt, *Improving the SEC's Best Execution Rule*, Columbia Law Schools' Blog on Corporations and the Capital Markets, June 24, 2021 (advocating for the banning of rebate price tiers) https://clsbluesky.law.columbia.edu/2021/06/24/improving-the-secs-best-execution-rule/.

[33] This analysis was conducted based on historical Nasdaq fee schedules. For instances where the top tier required a particular type of volume, whether expressed in absolute shares or in % of TCV, that number was converted to, and expressed in, % of TCV terms.



Exchange filings themselves demonstrate the intent to ensure tiers remain highly restrictive. For example, Nasdaq's 2022 filing that restated its schedule of transaction fees included a reduction in the amount of the rebate provided for members that achieve certain volume thresholds. According to the filing, "**the purpose of the changes is to recalibrate the credits to account for changes in member behavior over time that have rendered the credits less challenging for members to attain. That is, the Exchange proposes to reduce the amount of the credits because members now readily meet the volume requirements to qualify for them, such that the credits reward these members for remaining static in their activity on the Exchange.**"[34] In other words, it is not enough to set the bar so high that few members can meet it. The exchanges seek to keep raising the bar so the best pricing remains sufficiently exclusive.

The bottom line is that the Exchange Act prohibits exchange practices that act as a burden on competition unless the burden is "necessary or appropriate" to further the purposes of the Exchange Act. There is compelling and clear evidence that the current system creates a burden on competition. There is no evidence or justification that has been advanced as to why that burden is necessary or appropriate to achieve any objectives under the Exchange Act.

<u>Impact on Investors</u>

As noted, the 1975 Amendments directed the Commission, in building the NMS, to promote economically efficient execution of securities transactions and the practicability of brokers executing investors' orders in the best market. As the Commission explains in the Proposing Release, the tier system negatively impacts investors in at least two ways – by distorting routing incentives that can lead to worse execution outcomes and by limiting the pool of brokers available to handle their orders.[35]

[34] Nasdaq 2022 Fee Filing, at 36563.

[35] Proposing Release at 88 FR at 76288, 76317.

Tiered pricing creates strong incentives for brokers to route, directly or indirectly, on the basis of their ability to achieve tier pricing benefits rather than to meet best execution objectives and provide the best outcome for clients.[36] As explained above, the extent of the benefits available to brokers that can qualify for tiered pricing and the importance of those benefits to firms' bottom lines means that they will naturally be led to route orders where that benefit is the greatest. It is a known practice that certain traders factor for rebates in their automated trading strategies when routing for customer orders. In such cases, brokers can be unduly influenced when the routing decision is driven by economic incentives to maximize rebates received instead of routing to the venue that has the highest likelihood of offering the best execution.[37]

Further, the execution outcome for investors is not equal among exchanges. In fact, as IEX and others have demonstrated, the execution outcome for investors is *worse* in relation to the size of the maximum rebate payout.[38] This is true for various reasons, including the fact that crowding

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[36] *See* Steven R. McNamara, The Law and Ethics of High-Frequency Trading, 17 MINN. J.L. SCI. & TECH. 71, at 149-150 (2016) (explaining that "the maker/taker payment system appears to incentivize brokers to route their clients limit orders to the trading venue that offers the highest liquidity rebate, rather than the one offering the best likelihood of execution," thereby offering "incentives tempting broker dealers to compromise their institutional integrity."); *see also* CFA Institute Research Foundation, The Principal-Agent Problem in Finance (April 2014) (explaining that "whenever the [principal and agent] entities' interests are misaligned and monitoring is difficult, the agent could act in a way that does not reflect the principal's best interests. Such is the basis of the principal–agent problem.") https://www.cfainstitute.org/-/media/documents/book/rf-lit-review/2014/rflr-v9-n1-1-pdf.ashx.

[37] *See* Steven R. McNamara, The Law and Ethics of High-Frequency Trading, 17 MINN. J.L. SCI. & TECH. 71, at 149-150 (2016) (explaining that "the current market structure appears to incentivize broker dealers to violate their duty of best execution for clients"); *see also* Michael J. McGowan, The Rise of Computerized High Frequency Trading: Use and Controversy, 9 *Duke Law & Technology Review* 1-25 (2010) (explaining that some of the most popular high frequency trading strategies include automated low latency arbitrage and liquidity rebate trading and that "liquidity rebate traders make a profit by looking for large order flows and then filling a part of a large order, then re-offering the shares at the same price and collecting the exchange fees for providing liquidity to the market."); *see also Conflicts of Interest, Investor Loss of Confidence, and High Speed Trading in U.S. Stock Markets*: Hearing Before the Permanent Subcommittee on Investigations of the S. Comm. on Homeland Sec. & Governmental Affairs, 113th Cong. (2014), Statement from Senator Levin (explaining that "the important thing to remember is that brokers, by maximizing maker rebates and by avoiding taker fees, can add millions of dollars to their bottom line, giving them a powerful incentive to send the order to the trading venue that is in their best interest even if it is not in their client's best interest.") https://www.govinfo.gov/content/pkg/CHRG-113shrg89752/html/CHRG-113shrg89752.htm; *see also* Battalio, Robert H. and Corwin, Shane A. and Jennings, Robert H., *Can Brokers Have It All? On the Relation between Make-Take Fees and Limit Order Execution Quality* (October 20, 2015) (economic study finding that order routing decisions have an important impact on limit order execution quality and that routing decisions based primarily on rebates/fees are inconsistent with best execution) https://ssrn.com/abstract=2367462.

[38] *See, e.g.*, Conflicts of Interest, Investor Loss of Confidence, and High Speed Trading in U.S. Stock Markets: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Governmental Affairs, 113th Cong. (2014) (noting that Professor Robert Battalio of the University of Notre Dame has done research indicating that when, given a choice, leading brokers send their orders to the markets offering the biggest rebates at every opportunity. The research further suggests that exchanges offering the highest rebates do not, in fact, offer the best execution for clients). https://www.govinfo.gov/content/pkg/CHRG-113shrg89752/html/CHRG-113shrg89752.htm; Battalio, Robert H. and Corwin, Shane A. and Jennings, Robert H., Can Brokers Have It All? On the Relation between Make-Take Fees and Limit Order Execution Quality (October 20, 2015) (economic study finding that there is an inverse relationship between the exchanges' rebates and the execution quality provided to

of orders to trade at a certain price by trading firms seeking to qualify for the tier benefit means that investors' orders are typically executed behind those orders, when they are most likely to suffer "adverse selection", that is, when the price of the security they are trading is likely to move against them.[39] This results, in large part, from the fact that high rebate tier payouts are subsidized by access fees that are set at the legal maximum, deterring "takers" of liquidity from trading on these exchanges except as a last resort. Therefore, the effect of these misaligned incentives is such that routing of orders where they are likely to receive a worse execution is a frequent, not occasional or random, result.[40]

Organizations representing institutional investors have spoken to the pernicious effects of tiered pricing on their members.[41] Based on comparative data on execution quality, the conflict of interest is tangible, not hypothetical. The result is that brokers, in their effort to achieve best execution, are in effect being asked to ignore their own self-interest to a significant degree. Market structure should not require brokers to make choices for their customers that can be so directly at odds with their own interests. Instead, the rules should seek to align the interests of brokers and their customers wherever possible.

The second, indirect, impact is that the burden on competition among broker-dealers means investors have fewer choices of brokers who can provide direct access to exchange markets

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orders; the exchanges that paid the most to brokers also offered the lowest likelihood of limit order execution (or fill rate) to the brokers' customers). https://ssrn.com/abstract=2367462. As IEX explained in a recent comment letter, maker-taker exchanges that rely on tiered pricing have quotes that are both less stable, in terms of how frequently the best bid and offer prices change, and provide substantially worse execution quality, in terms of high costs from "adverse selection". *See* Letter from John Ramsay, Chief Market Policy Officer, IEX, to Vanessa Countryman, Secretary SEC, dated March 20, 2023, avail. at https://www.sec.gov/comments/s7-30-22/s73022-20160364-328968.pdf, at 10-12.

[39] *See, e.g.*, Goldman Sachs Comment Letter (2/26/2020) (explaining that adverse selection has a negative effect on the national market system and discussing the critical importance of efficient price discovery for displayed orders and the need to mitigate latency arbitrage practices as they do not advance the goals of the Exchange Act) sriex201915-6873861-210636.pdf (sec.gov); Jefferies Comment Letter (2/5/2020) (commenting on the problem of adverse selection of getting "picked off" by arbitrage-based strategies relying primarily on speed) sriex201915-6772521-208081.pdf (sec.gov); T. Rowe Price Comment Letter (2/5/2020) (commenting on market participants getting "picked off" when the price of a security is in transition to a new price level, which continues to plague displayed markets) sriex201915-6772531-208082.pdf (sec.gov).

[40] Further, because of the extreme complexity of the system, even sophisticated institutional investors are not able to evaluate how and to what extent the tiered pricing can impact the net price and other aspects of execution quality. Even if investors knew the precise amount of the rebate benefit for each of their trades at the time of each trade (which is not the case), asset managers and other intermediaries would not be able to reliably allocate those benefits among each of the potentially thousands of managed accounts.

[41] *See, e.g.*, Healthy Markets Association, *Letter to Gary Gensler re: Transaction Pricing Practices* (November 16, 2022) (discussing the facial inconsistency between the customer-based pricing tiers and what is required under the Exchange Act, and explaining the inherent conflicts of interest and competitive disadvantages created by different pricing tiers); American Securities Association Letter (Mar. 31, 2023) (commenting that the current tiered rebate pricing scheme "should concern the SEC" as it imposes a burden on market competition and is a discriminatory practice that does not fairly allocate exchange fees amongst all its members as required by law), s73222-20163332-333215.pdf (sec.gov).

and fewer liquidity providers on those markets competing to provide the best price. To argue that investors benefit from the existing system and would be harmed by restricting the use of pricing tiers, one would need to believe that investors benefit from an increasing concentration among broker-dealers, less competition for their business, and fewer choices. That premise is at odds with basic principles of free market competition and common sense.

Impact on Market Venue Competition

As noted above, the 1975 Amendments directed the Commission, in creating the NMS, to promote fair competition, not only among broker-dealers, but also among exchanges. In addition, the standard that exchange rules do not burden competition is not limited by type of participant and also applies to exchanges.

As explained in the Proposing Release, the rebate tier system drives large exchange operators to compete largely on the basis of an increasingly opaque and complicated system of transaction pricing rather than on other measures that matter more to market quality and investor welfare.

Further, individual exchanges that use tiering to attract orders are strongly disincentivized to depart from this practice on their own. As the Commission noted, this is a classic example of a collective action problem. Any one exchange that eliminated use of tiers would likely incur a significant loss of market share to other competitors that continue to offer tiered pricing. Further, any new or smaller exchange that sought to compete by matching the top tier payouts would not have the incoming order flow to support those payments and so would be forced to operate at a loss.[42] In fact, the rebate tier system is less about drawing more displayed liquidity to exchanges, than a means by which some exchanges seek to draw orders from *other exchanges* or to maintain their current market share.

In addition to the effect of tiered pricing on routing behavior, the system requires exchanges to rely more heavily on revenues for market data and connectivity, because price tiering is associated with net transaction fees as low as 2 mils per share, according to the Commission's estimate.[43] Moreover, the top rebate payout for some firms may exceed the maximum access fee of 30 mils, meaning that exchanges are losing revenue on some trades with favored clients. In contrast, the much more equally applied subscription fees impact small and mid-size brokers much more heavily than firms that can achieve the best tiers. For this reason, the reliance on subscription products for revenue reinforces the competitive burden on the majority of exchange members.

In adopting Regulation NMS, the Commission repeatedly stressed that a central objective of the regulation was to balance competition among orders and competition among markets.[44] For the

[42] Proposing Release at 77.

[43] Securities Exchange Act Release No. 96494, 87 FR 80266 (December 29, 2022), at 80312.

[44] Regulation NMS, Exchange Act Release No. 51808, 70 Fed. Reg. 37496, 37503 (June 29, 2005) (Regulation NMS Adopting Release"):

> "The NMS is premised on promoting fair competition among individual markets, while at the same time assuring that all of these markets are linked together, through facilities and rules, in a unified system that promotes interaction among the orders of buyers and sellers in a particular NMS stock.

reasons given above, the impact of the tier system is that competition among orders is distorted by the narrowing of the channels through which orders are routed to exchanges. And competition among markets is distorted by the undue emphasis placed on rebates and transaction fees, and other sources of revenue, rather than on competition to deliver the best outcome for investors.

Distortions in Capital Allocation

Another impact of tiered pricing is to create distorted incentives for broker-dealers to allocate capital to low-priced or marginal stocks to the exclusion of other stocks. Because tiered pricing is based on per-share trading volume in NMS stocks, as much credit is given to trading in "penny stocks", which typically are issued by financially vulnerable companies subject to delisting, as to other securities. In the last two years, stocks trading at less than $1.00 per share, particularly those listed on Nasdaq, have grown to constitute a significant share of overall market volume. Although these stocks may be subject to delisting, they may remain listed for a long period after they fall below minimum requirements.[45]

In fact, during 2023, stocks trading at a price of less than $1 have regularly accounted for an incredible 15-20% of overall stock volume. Bit Brother Limited (symbol BETS) is a case in point. BETS is a Chinese company involved in bitcoin mining, among other activities, and is currently trading for barely more than one cent per share (a literal "penny stock"), and recently had a market capitalization of about $2.3 million.[46] From December 1 to December 13, BETS alone accounted for more than 5% of all NMS market volume. During the last week of December, BETS' volume average about 2 billion shares per day, accounting for 19% of overall volume, higher than the volume of any single exchange. And on December 27, BETS traded approximately *3.5 billion shares, accounting for about 30% of all market volume that day.*

To the extent that tier volume thresholds are unrelated to share price or other measures of capitalization, brokers and dealers may have an incentive to increase trading in marginal stocks such as BETS that require less capital outlay on a per share basis. That increased level of trading activity may also have the practical effect of increasing the apparent level of market interest in very low-priced stocks that are subject to or would qualify for delisting. Finally, because so many pricing tiers are expressed as a percentage of total market volume, a sudden increase in trading in such securities makes meeting TCV tiers even more difficult (since the

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The NMS thereby incorporates ***two distinct types of competition***—competition among individual markets and competition among individual orders—that together contribute to efficient markets. Vigorous competition among markets promotes more efficient and innovative trading services, while integrated competition among orders promotes more efficient pricing of individual stocks for all types of orders, large and small. Together, they produce markets that offer the greatest benefits for investors and listed companies. Accordingly, the Commission's primary challenge in facilitating the establishment of an NMS has been to maintain an appropriate balance between these two vital forms of competition." (emphasis added)

[45] *See* Wall Street Journal, "Hundreds of Stocks Have Fallen Below $1. They're Still Listed on Nasdaq", December 3, 2023, avail. at https://www.wsj.com/finance/stocks/hundreds-of-stocks-have-fallen-below-1-theyre-still-listed-on-nasdaq-c8e36abf?mod=Searchresults_pos1&page=1.

[46] *See* https://www.bitbrother.com/.

"denominator" of TCV grows so much), further contributing to the distortions that pricing tiers create.

Specific Comments on SEC Proposal

Volume-Based Tier Prohibition

For the reasons explained above, the SEC has more than ample basis and justification to restrict the use of pricing methods that distort incentives and run counter to the goal of fair and efficient markets and multiple other objectives of the Exchange Act, any one of which provides a basis for the Commission to act.[47] Further, the SEC's proposal does not arise in a vacuum, but grows out of long-term consideration of concerns surrounding the rebate system in recent years.[48] IEX supports the proposal to eliminate volume-based pricing for agency and riskless principal orders because we believe it will most effectively address the problem as it affects those orders. At the same time, for the reasons explained below, we believe that this restriction should also be extended to principal orders.

Prohibiting the use of volume-based tiers is an appropriate and reasonable response to identified problems that arise from tiered pricing, because it will most effectively address the impacts of undue complexity, unfair discrimination, inequitable allocation of fees, and the burden on competition that arise from tiered pricing.

First, it would most effectively address concerns with undue complexity and opaqueness of exchange pricing schedules. The ability of participants to understand and adapt to pricing differences among exchanges will be dramatically simplified, improving efficiency and the ability of investors to better evaluate the impact of exchange fees on order routing. And market participants will no longer need to spend time and resources to solve the riddle of how the more than 1,000 pricing paths affect their business and try to update their understanding every month.[49]

A prohibition on volume tiering would also substantially reduce agency conflicts. Exchanges could still differ in the fee and rebate rates they offer for executing different types of orders, but because the differences will be dramatically simplified and determinable at the time of each trade, investors and their fiduciaries will be substantially better positioned and equipped to monitor for conflicts.

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[47] *See, e.g.*, *Alliance for Fair Board Recruitment v SEC*, No. 21-60626, at 47, 49 n.36 (5th Cir. Oct. 18, 2023) (rejecting objector's claim that the SEC acted arbitrary and capricious in its independent review of SRO rules and explaining that the SEC need not "measure the immeasurable," "was not required to conduct or commission its own empirical or statistical studies," and explaining that the courts must "be mindful of the many problems inherent in considering costs and uphold a reasonable effort made by the [SEC]").

[48] *See* https://www.reuters.com/article/us-sec-exchanges-fees-exclusive/exclusive-sec-scrutinizes-fairness-of-stock-exchange-pricing-idUSKCN1QO2CY.

[49] *See, e.g.*, The Clearpool Group Letter, SEC Roundtable on Market Data and Market Access (Oct. 23, 2018) (independent broker commenting that tiered pricing structures "challenge the concept of 'fair access' and, with hundreds of different pricing tiers and related order types, contribute to the opacity around pricing and the complexity of the markets.") 4729-4555206-176185.pdf (sec.gov).

Further, a prohibition on tiered pricing would appropriately and most effectively address concerns with inequitable fees, unfair discrimination, and burdens on competition. Customers will no longer be driven to restrict the brokers they use to the highest-volume firms, and broker-dealers will no longer be driven to rely on their competitors to access the market and seek to capture some of the benefits those firms enjoy.

Limitations on tiered pricing that are short of a simple prohibition could provide some relative benefit, but it would be incomplete and could create other problems. For example, permitting tiered pricing but requiring that any tier must be accessible to some minimum number of participants could be difficult to administer, and any specific number chosen could be difficult to justify. Further, under that alternative, the Commission would effectively be in the position of determining itself how many firms could qualify for exclusive pricing benefits, which would be counter-purposeful. Prohibiting TCV tiers while allowing other forms of tiered pricing could reduce negative effects, but the prohibition might be too easily evaded by the use of monthly updates to tiers expressed in aggregate volume, with those levels being set to mimic TCV requirements.

IEX does not believe that mandating more disclosure about tiers by itself would address these concerns in a material way. It is already well understood by most participants that tiered pricing creates distortions and gross inequities.[50] There is no reason to believe that requiring exchanges to disclose more information about the explicit impacts, in terms of number of firms qualifying for a tier level, or otherwise, will cause exchanges to alter their fee schedules to any significant degree.

Further, exchanges would maintain full flexibility to offer different fee and rebate rates for different types of trading and orders, for example, based on different categories of securities, for displayed versus non-displayed volume, for different order types, and for trades by firms acting as a registered market maker or in other capacities. They could differentiate based on the type of activity they want to most encourage. The difference is that they could not discriminate against firms in ways that create large subsidies for a few members at the expense of the many.[51]

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[50] *See, e.g.*, Christine Stebbins, ICE CEO Sprecher wants regulators to look at 'maker-taker' trading | Reuters (Jan. 26, 2014) (Jeffrey Sprecher, CEO of Intercontinental Exchange (which owns the NYSE), voiced concerns about rebate models, explaining that it "hurts everybody in the market" and noting that the SEC "need[s] to look harder at the issue" as the exchange can't "unilaterally change it alone."); Decimus Capital Markets, LLC Letter (Apr. 25, 2016) at 3 (stating that "the National Best Bid and Offer could be distorted by variations in fee-rebate structures, potentially hurting market participants whose orders are disadvantaged by routing practices that do not minimize costs".) 26529-63.pdf (sec.gov); Tomio Geron, Protocol *It's not just Robinhood. Money-hungry stock exchanges are under scrutiny too* (July 30, 2021) Why stock exchange rebates are attracting growing regulatory scrutiny - Protocol (noting that rebate models have led to market concentration and a reduction in competition, and explaining that the pricing of rebates varies, typically with better pricing for clients trading a larger percentage of total daily market volume and discussing that such benefits larger clients and makes it harder for smaller firms to compete, which "hurts competition").

[51] *See* The Clearpool Group Letter, SEC Roundtable on Market Data and Market Access (Oct. 23, 2018) (independent broker-dealer commenting that the current market structure creates an unfair environment where smaller broker-dealers are subsidizing the larger-sized firms' trading costs given the tiered pricing structures). 4729-4555206-176185.pdf (sec.gov); *SEC Scrutinizes Fairness of Stock Exchange Pricing*, Reuters (Mar. 7, 2019) (stating that tiered pricing makes it harder for smaller brokers to compete and

Finally, eliminating rebate tiers will not impede the ability of brokers or their customers to benefit from scale economics. Firms that have the ability to make the infrastructure investments needed to provide liquidity on multiple exchanges will continue to have an advantage over firms that do not. Firms that currently have access to more customer order flow will continue to have an advantage over those that don't. And the same firms will benefit from higher aggregate fee payments based on the volume of orders that they can generate or handle. The difference is that a small number of participants will not be able to gain an undue advantage based solely on their size.

Extending the Prohibition to Principal Order Flow

IEX believes the restriction on tiered pricing should be extended to principal order flow, for the following reasons.

As the Commission notes, the disparate impact of tiered pricing on market makers and other firms trading as principal is similar to the impact on agency order flow. In some ways, the burden on competition is even greater because market makers are more heavily dependent on exchange pricing for net profits and ability to compete, given that they cannot rely on commissions or other sources of agency revenue.

Because the margins determining profitability of market making can be so narrow, exchanges using tiered pricing are effectively picking winners and losers among the firms trading as principal on their markets. As noted above, the difference in payout between the top and next tier may be one mil or less, but the additional volume required to qualify for the higher payout can be extremely large. This confirms that small differences in per share payout can be extremely meaningful for firms trading in the volumes required to make markets in hundreds or thousands of stocks on many different exchanges simultaneously. There is no more justification for allowing exchanges to use their special regulatory status and authority to pick winners and losers among principal trading firms than among agency brokers.

As the Commission acknowledges, if agency-related flow alone were subject to the ban on tiering, it is likely that concentration in principal flow could increase even more than it is now. Exchanges likely would leverage their ability to discriminate further in favor of the small number of firms that can achieve high TCV volume levels, and firms that trade as principal and agent can use that benefit to subsidize their agency business.

Also, the same firms could more readily employ a "customer facilitation" model that depends on their ability to maintain an inventory and manage the market risk of buying from and selling to customers as principal. The Proposing Release cites to data that the majority of firms in the top quarter of all firms for volume of principal order flow are also in the top quarter of firms handling agency orders, suggesting that firms in this category could be easily able to translate their principal order flow advantage into the agency sphere.[52]

Further, it does not appear that the anti-evasion elements of the Proposal would blunt this concern. Exchanges would not be able to readily prevent firms from labelling and submitting as

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quoting a chief executive of a brokerage firm that tiered pricing "discriminates against smaller broker dealers who end up almost perversely subsidizing the cost of the whole exchange relationship for the largest firms"). https://www.reuters.com/article/us-sec-exchanges-fees-exclusive/exclusive-sec-scrutinizes-fairness-of-stock-exchange-pricing-idUSKCN1QO2CY.

[52] Proposing Release, at 76318-19.

principal orders that they hold in inventory, even if briefly, to facilitate transactions for investors or other customers. Too, it would not seem administratively feasible to require firms to maintain procedures to distinguish between facilitation activity that is intended to evade the prohibition compared to activity they engage in for this purpose today.

Importantly, the relevant statutory standards do not distinguish between types of firms or order flow. The Exchange Act calls on the Commission to promote fair competition among **brokers and dealers** in developing the NMS. The prohibition on unfair discrimination is written to apply without distinction to brokers and to dealers. And the Exchange Act prohibits all burdens on competition that are not necessary or appropriate to serve the purposes of the Exchange Act.

From this perspective, as explained above, tiered pricing for principal trading creates a burden on competition very much like that imposed on firms routing orders as agent. Therefore, to justify the distinction between tiered pricing for agent compared to principal orders, the Commission would need to be able to clearly explain why the burden on competition for principal orders, but not agency orders, is necessary or appropriate to achieve some purpose under the Exchange Act.

In this regard, an assertion or conjecture about the impact on displayed liquidity resulting from prohibiting tiered pricing is clearly insufficient. This assertion appears to be based on a premise that markets will suffer if concentration of principal order flow were reduced and more firms were incentivized to post displayed orders. That premise is illogical on its face, but in any event, it is not the Commission's role or responsibility to prove an unprovable negative. Instead, the statute calls on the Commission to ensure that exchanges' rules do not create a burden on competition unless it concludes that the burden is justified as "necessary or appropriate" to meet the objectives of the Exchange Act. No participant has come close to providing evidence that this is the case.

Potential Alternatives

As discussed, IEX believes that the prohibition on tiered pricing should be extended equally to principal orders. If, however, the Commission concludes that a distinction between order capacity is necessary, IEX believes any exception should be carefully limited.

One possible alternative is to provide a limited exception for registered market makers, one of the alternatives identified in the Proposing Release. Under that alternative, only orders submitted by registered market makers that meet specified market quality standards would be excluded from the general ban on tiered pricing.

We believe a limited carve-out for registered market makers could be better justified than a general exception for principal orders for several reasons. First, registered market makers play a unique role in providing liquidity on exchanges based on exchange rules that specify their responsibilities and obligations. They also are subject to defined standards in terms of quoting activity that help to ensure that they contribute in measurable ways to market quality.

Because of the unique role played by registered market makers, there is precedent under Commission and exchange rules to provide different regulatory treatment to firms operating in

that role, in specific contexts.[53] When more favorable treatment is provided, the trade-off is that those firms must commit to contribute to liquidity in meaningful and measurable ways.

IEX believes that, if the Commission adopted this alternative, it should explicitly prohibit the tying of auction-based fees to intra-day market volume. For reasons explained in the Proposing Release, these tying arrangements have anti-competitive impacts independent of general concerns about tiers. For the reasons we have explained, the pernicious effects of tiered pricing grow out of exchange's unique regulatory status. Listing markets (which are effectively limited to two at present) have even greater leverage to use that status to affect how firms route their non-auction related volume. This form of tying would allow the two dominant listing markets to use that duopoly status to maintain a dominant share of the market in their listed stocks, both in opening and closing auctions and other times during the day. That would represent an especially noxious and impermissible constraint on competition. If the Commission allows any exception for tiered pricing, it should close off the potential for this particular type of abuse.

Comments Concerning Pricing Incentives by ATSs

The Commission sought comment on whether the proposed rule should apply equally to exchanges and ATSs. IEX does not believe that it is necessary to subject ATSs in general to the prohibition on tiered pricing. First, ATSs are not subject to the specific statutory standards detailed above, governing exchange rules in Section 6 of the Exchange Act, reflecting differences in their regulatory status and oversight. Further, no ATSs presently have the ability to maintain protected quotations, which exclusively set the NBBO. For that reason, ATSs are not subject to the cap on access fees, and their transaction pricing does not raise the same concerns about distortions in displayed pricing and efficiency in accessing displayed quotes.

Finally, because ATSs do not have protected quotations, they do not have the same ability to charge high access fees. As IEX has detailed in a previous letter, their access fees typically are no more than 10 mils. As a result, any rebate benefits they provide are in practice substantially less than those offered by exchanges, and their pricing schedules do not come close to the extraordinary disparity in treatment shown by exchange pricing schedules.

At the same time, IEX believes it is important that any restrictions on tiered pricing by exchanges are applied to any ATS that is granted a protected quotation by the SEC. First, this would be consistent with the fact that the access fee cap of Rule 610 is applied to any protected quotation or any other quote that is the best bid or offer of an exchange or a national securities association.[54] In adopting the cap, the Commission stated that applying the cap to all markets with protected quotations was meant to "place all markets on a level playing field in terms of the fees they can charge and the rebates they can pass on to liquidity providers."[55]

Further, applying the prohibition to all markets with protected quotations is necessary to avoid distortions in the prices reflected in displayed quotes, consistent with the objectives of Section 11A)(c)(1)(B) of the Exchange Act. It also would further the objectives of incentivizing brokers to

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[53] *See* 17 C.F.R. 242.203(b)(2)(iii) (bona fide market making activities excepted from short sale pre-borrow requirements); 17 C.F.R. 242.204(a)(3) (providing additional time to close out fail to deliver position attributed to bona fide market making activity).

[54] *See* 17 C.F.R. 242.610(c).
[55] Regulation NMS Adopting Release, 70 FR at 37545.

route orders to the best market and assuring fair competition among brokers, dealers, and exchanges. If any ATS is granted a protected quotation, it must be held to comparable standards of other markets that are given that benefit.[56]

Conclusion

Unlike other businesses, the way that exchanges price their services affects more than their own commercial interests and the way they compete for business. Because exchanges serve as the linchpin of the equity markets and have been granted special status by regulation, their pricing methods affect how *everyone else* in the equity markets competes for business. In some respects, they also determine *who* can compete at all in a particular capacity. Exchanges are nothing like wholesale discount stores, and they are certainly not private clubs that can set fees and allocate benefits however they see fit. The Exchange Act gives the SEC the authority and direction to oversee all aspects of their business so that they serve public, not just private, interests.

Existing pricing tier practices demonstrably and unfairly discriminate among market participants, make markets substantially more complicated and opaque, run counter to the interests of investors to receive the best execution, and hinder competition without any benefit that would justify these effects. The Exchange Act gives the SEC all the authority it needs to address these harms. The SEC has all the reason it needs to take action to prohibit the practices that cause them.

Sincerely,

John Ramsay
Chief Market Policy Officer, IEX

[56] Section 11A directs the Commission to assure "fair competition among brokers and dealers and among exchange markets." ATSs meet the definition of "exchange" under Rule 3b-16 of the Exchange Act, and any ATS with quotes that are required to be accessed in the same way as those of registered exchanges should be subject to the same pricing restrictions. To effect this change, the text of proposed Rule 6b-1 could be easily amended to state that any "national securities exchange, *or any other trading center with a protected quotation*, shall not offer volume-based transaction fees, rebates or other incentives…"