January 5, 2024

Submitted electronically

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Securities Exchange Act Release No. 98766 (S7-18-23) (Volume-Based Exchange Transaction Pricing for NMS Stocks)

Dear Ms. Countryman:

MEMX LLC ("MEMX") appreciates the opportunity to provide comments to the U.S. Securities and Exchange Commission ("Commission") on the above-referenced proposed rule change.[1] Among other things, the proposed rule change would: (1) prohibit national securities exchanges from offering volume-based pricing incentives for agency and riskless principal ("agency-related") orders in national market system ("NMS") stocks;[2] and (2) require national securities exchanges to make monthly disclosures about volume-based tiers offered for proprietary

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[1] See Securities Exchange Act Release No. 98766 (October 18, 2023), 88 FR 76282 (November 6, 2023) (S7-18-23) ("proposed rule").

[2] A "riskless principal" transaction is defined in the proposed rule as "a transaction in which, after having received an order to buy from a customer, the broker or dealer purchased the security from another person to offset a contemporaneous sale to such customer or, after having received an order to sell from a customer, the broker or dealer sold the security to another person to offset a contemporaneous purchase from such customer." Id. This definition differs from the standard definition of riskless principal as it removes the requirement that the principal trade and the customer fill occur at the same price.

orders in NMS stocks.[3] According to the Commission, the goal of the proposed rule is to: (1) mitigate conflicts of interest inherent in broker-dealer routing of agency-related orders in NMS stocks; (2) facilitate competition between broker-dealers transacting in such stocks; and (3) facilitate competition between national securities exchanges that offer trading in such stocks.[4] MEMX's comments focus primarily on the goal of facilitating competition between exchanges.

MEMX is a new exchange operator founded by a diverse group of market participants to bring competition to the U.S. securities markets. As such, MEMX believes that it is uniquely qualified to comment on the impact that current pricing structures have on exchange competition as well as potential opportunities for the Commission to update its regulatory framework to promote such competition, consistent with Congress's goals for the national market system. At the same time, MEMX is cognizant that regulation of exchange pricing practices has market structure consequences not only for the exchanges being regulated but also for the broader U.S. equities ecosystem. Our comments are therefore designed to balance the benefits of robust competition against the potential costs associated with any rules being considered by the Commission.

Volume-based pricing is an important part of an exchange's toolkit and contributes to our collective ability to attract the liquidity needed for a robust U.S. equity market. For this reason, MEMX does not support a blanket prohibition of volume-based pricing for agency-related orders. A more targeted approach that addresses specific identified issues would allow the Commission to tackle its concerns about competition without negatively impacting available liquidity. Rather than

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[3] A "proprietary order" is an order "where the member is trading solely for its own account and not in connection with filling an order for a customer." Id at 76293. The Commission uses this term interchangeably with the more commonly used "principal order" and we therefore use those terms interchangeably in our comments.

[4] Id at 76285.

moving forward with the proposed rule, MEMX recommends that the Commission instead prohibit specific tier structures that are used to "lock in" order flow on the largest exchanges without contributing to liquidity provision. As discussed in more detail below, the Commission should:

1. Require that any volume-based transaction pricing offered by a national securities exchange be expressed in a fixed number of shares rather than a percentage of total consolidated volume ("TCV") or other industrywide volume measure, except in certain limited circumstances where TCV is used solely to protect members or the exchange when market volumes deviate significantly from historical norms.

2. Prohibit "auction linked pricing," defined as a discount or incentive offered by the primary listing exchange on auction (continuous order book) pricing based on continuous order book (auction) volume and/or subject orders executed in primary listing exchange auctions to a fee cap that is materially lower than the current fee cap provided in Rule 610(c) of Regulation NMS (the "Access Fee Cap").[5]

These recommendations are based on the Commission continuing to permit access fees of up to $0.0030 per share in most NMS stocks. The Commission has separately proposed to reduce the Access Fee Cap to $0.0010 or $0.0005 per share depending on the time-weighted average quoted spread of the security.[6] In our comments to that proposal, we recommended that the Commission instead reduce the Access Fee Cap to $0.0015 per share only in tick-constrained NMS

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5 The Access Fee Cap currently prohibits fees exceeding $0.0030 per share for orders in NMS stocks executed against a protected quotation. This prohibition does not apply to orders executed in listing exchange auctions today.

6 See Securities Exchange Act Release No. 96494 (December 14, 2022), 87 FR 80266, 80312 (December 29, 2022) (S7-30-22) (Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders).

stocks that data shows could be traded more efficiently in a half-penny minimum increment, i.e., commensurate to the recommended change in tick size for those stocks.[7] However, if the Commission determines to make further reductions to the Access Fee Cap, particularly changes applied across a broader range of NMS stocks, such changes are likely to result in flatter tier structures than implied by the current regulatory baseline. Given the interconnected nature of the proposals, we request that MEMX and other market participants be given an additional opportunity to comment on the proposed rule if the Commission proceeds with changes to the Access Fee Cap.

I. A BLANKET PROHIBITION ON VOLUME-BASED PRICING FOR AGENCY-RELATED ORDERS WOULD HAVE A NEGATIVE IMPACT ON LIQUIDITY PROVISION THAT THE COMMISSION HAS NOT ANALYZED

As the Commission is undoubtedly aware through its required review of exchange rule filings, volume-based pricing is often used to incentivize robust displayed liquidity. By offering the best rebates to market participants that route the most order flow, exchanges can encourage those firms to increase liquidity provision, providing a positive externality to other market participants. Eliminating volume-based pricing for all or a subset of orders therefore comes at the cost of removing an important tool that is used to facilitate a robust and liquid market. Although MEMX stands to benefit if the proposed rule is successful in increasing exchange competition, we are concerned that the Commission has not even attempted to analyze the potential impact that the proposed rule may have on displayed liquidity. Perhaps in recognition of the potential impact of a broader prohibition on available liquidity, the proposed rule would prohibit volume-based pricing

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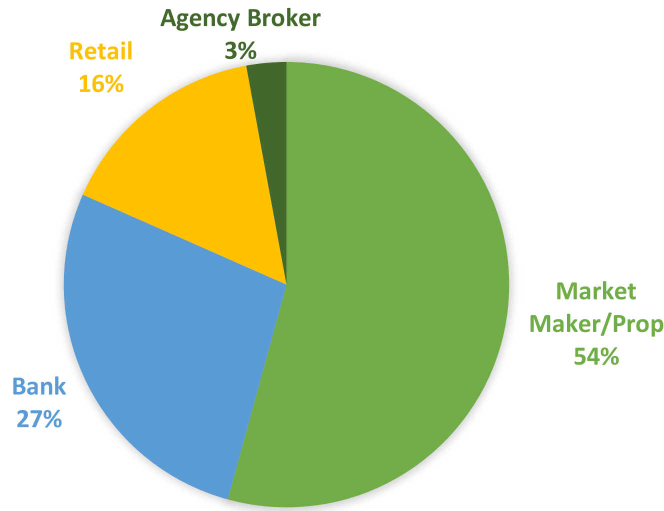
7 See Letter from Adrian Griffiths, Head of Market Structure, MEMX to Vanessa Countryman, Secretary, Commission dated March 31, 2023 *available at* https://www.sec.gov/comments/s7-30-22/s73022-20163328-333796.pdf.

only for agency and riskless principal orders but not proprietary orders, which would instead be subject to a disclosure regime. However, to the extent the Commission is making this distinction to address the potential impact on liquidity, it is not clear that this would be the actual result.

About half of displayed liquidity executed on MEMX is marked principal. The Commission assumes correctly that this order flow comes primarily from registered market makers or other professional liquidity providers. The other half includes agency orders entered on behalf of: (1) retail and institutional customers; and (2) sponsored customers that use the services of sponsoring brokers for market access. Sponsored customers can be sophisticated institutional investors, e.g., quantitative hedge funds, or other broker-dealers that utilize infrastructure provided by the sponsoring broker to access the market. MEMX has observed that sponsored customers often employ liquidity provision strategies that are similar to and compete directly with principal market makers, with the only relevant difference being how these firms access the exchange. Rather than alleviating the impact of the proposed rule on displayed liquidity, making arbitrary distinctions between which liquidity providers are eligible for higher (tiered) rebates versus those that are eligible for lower (untiered) rebates is likely to *increase* the impact on liquidity.

Chart 1: MEMX Add Volume Mix (November 2023)



Consider the following illustrative example: Liquidity Provider 1 ("LP1) and Liquidity Provider 2 ("LP2") are both active liquidity providers on MEMX. LP1 is a MEMX member and has built out the infrastructure necessary to trade on the exchange using its own market participant identifier ("MPID"). LP2 is not a MEMX member and utilizes the services of a sponsoring broker, Sponsoring Broker 1 ("SB1"), to access the market, trading directly on the exchange under SB1's MPID. Today, LP1 and LP2 both qualify for MEMX's highest displayed add rebate tier, i.e., $0.0033 per share, which compensates them for their contribution to market quality and the attendant risks that they incur when providing liquidity to other market participants.

The Access Fee Cap prohibits fees that exceed $0.0030 per share for orders executed against a protected quotation. As a practical matter, this means that it would be impossible for MEMX to profitably offer a $0.0033 per share rebate to all agency-related orders. Thus, if the Commission were to adopt a blanket prohibition on volume-based pricing for agency-related orders, MEMX would have to offer a lower blended rebate for such orders. For sake of this

example, let's assume this blended rebate is $0.0028 per share, which would allow the exchange to retain the Commission's estimated average net revenue capture of $0.0002 per share.[8]

Markouts for members that provide liquidity on-exchange are typically negative. In other words, earning the bid-ask spread is generally insufficient to compensate exchange liquidity providers for the risk of being adversely selected. Although retail and institutional investors may be willing to provide liquidity in certain circumstances to lower their overall cost of trading, professional liquidity providers must be compensated for this activity. This compensation comes primarily from rebates used to incentivize displayed liquidity. MEMX tracks member markouts over different time periods as well as a related statistic, markouts net of rebates, which combines markouts for liquidity providing orders with the member's displayed add rebate. Our observation is that while 100 millisecond markouts are generally negative, markouts net of rebates are slightly positive, indicating that liquidity provision is profitable only after accounting for the value of exchange rebates. For example, in October 2023, 100 millisecond markouts on MEMX were negative for both principal and agency orders but markouts net of rebates were both positive at $0.0013 per share for principal orders and $0.0009 per share for agency orders.[9]

If LP2's rebate were to go down by $0.0005 per share, its markout net of rebates would fall by the same amount to $0.0004 per share, i.e., based on the lower average for agency orders, or $0.0008 per share, i.e., based on the higher average for principal orders, which may better reflect LP2's activity. This represents a 38% - 56% reduction in profitability for LP2 not accounting for fixed costs of trading that would lower actual profitability for both firms. This sizeable reduction

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[8] See supra note 6.

[9] Markout numbers based on displayed add volume on MEMX.

in profitability would undoubtedly be reflected in the quality of LP2's quotes, resulting in wider spreads for investors. And, if LP2 is not able to profitably compete under this model, it may be forced to stop providing liquidity on the exchange entirely, further harming liquidity.[10]

Of course, it is possible that some firms that currently do not quality for displayed rebate tiers today might increase liquidity provision if the exchange implemented a higher (for them) blended rebate for agency-related orders. However, firms in the business of providing liquidity likely already qualify for the best tiers, and these firms are also the ones that are most sensitive to rebates and most able to increase or decrease liquidity provision based on pricing incentives. Thus, we expect that if the Commission adopted the proposed rule, liquidity lost from such market participants is likely to exceed any liquidity gained from others. With the exception of Consolidated Audit Trail ("CAT") data available to the Commission,[11] members are not required to identify the customer on whose behalf an order is entered. Therefore, it is impossible for MEMX as an exchange operator to identify the full impact of liquidity lost from these market participants, but anecdotal evidence about our customers' trading indicates that a significant portion of agency add volume may fall within this category. In any event, the Commission does have this

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[10] Although LP2 could theoretically choose to route orders to MEMX directly as principal instead of using sponsored access to trade as agency, whether this is in fact possible would depend on a number of factors. This includes, for example, the practicability and cost of building out infrastructure currently provided by SB1, and whether or not LP2 is a registered broker-dealer and therefore eligible to trade directly on the exchange.

[11] Pursuant to Rule 613 of Regulation NMS, MEMX and other self-regulatory organizations ("SROs") have access to CAT data only for surveillance and regulatory purposes.

information, and should perform its own analysis of the proposed rule's impact on liquidity provision.[12]

II. BROKERS ROUTE FOR BEST EXECUTION AND A BLANKET PROHIBITION OF EXCHANGE VOLUME-BASED PRICING FOR AGENCY-RELATED ORDERS IS NOT NEEDED TO ADDRESS ANY PERCIEVED BROKER CONFLICTS

When evaluating a proposed rule, it is important at the outset to understand the goal of such new regulation and what problems the proposed rule can and cannot solve, as this will inform which of available policy choices the Commission should select. Although we agree that the Commission should consider the impact that current tier structures have on competition, the proposed rule is also intended to address perceived conflicts of interest between broker-dealers and their customers. In turn, we believe that this concern may be animating the particular solution that the Commission has selected – i.e., a blanket prohibition on volume-based pricing for agency-related orders – instead of other solutions that may address competitive issues without imposing broader market structure challenges, such as the potential for reducing available liquidity.

Of course, any principal-agent relationship poses the potential for conflicts of interest. For this reason, brokers are already subject to rigorous best execution obligations that require them to "use reasonable diligence to ascertain the best market"[13] and "buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market practices."[14]

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12 See *Chamber of Commerce v. SEC*, No. 23-60255 (5th Cir. 2023) (holding that it was "arbitrary and capricious" for the Commission to ignore readily available data in its possession when determining the costs and benefits of its buyback disclosure rule).

13 FINRA Rule 5310.

14 Id.

Brokers therefore have already built robust compliance practices around achieving best execution, and these obligations are subject to oversight by the Financial Industry Regulatory Authority ("FINRA), other SROs, and the Commission itself. In addition, institutional investors routinely monitor routing and execution decisions of their brokers. Thus, while fees may pose a *potential* conflict of interest, these conflicts are already *managed* pursuant to existing regulatory obligations. The Commission has provided no evidence that these existing requirements are insufficient to address its concern with routing conflicts. Moreover, the Commission has also proposed a separate rule, Regulation Best Execution, that is intended to address these same conflicts[15]. The Commission has similarly not explained why that rule would not be better suited to address its stated concerns, or why regulation of *exchange* pricing practices is the best available policy choice for ensuring compliance with *broker* best execution obligations.[16]

In fact, while the proposed rule focuses exclusively on routing conflicts that stem from the variability of exchange fees and rebates *within* each exchange under volume-based pricing, it ignores the reality that there will always be variability of fees *across* execution venues. For example, when routing a customer order today a broker must choose between routing that order to a maker/taker exchange that provides a rebate for orders that provide liquidity and charges a fee for orders that remove liquidity; an inverted exchange that charges a fee for orders that provide

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15 See Securities Exchange Act Release No. 96496 (December 14, 2022), 88 FR 5440 (January 27, 2023) (S7-32-22) (Regulation Best Execution).

16 By this comment MEMX does not intend to imply that a Commission best execution rule is necessary, or that the rule actually proposed by the Commission is superior to the existing best execution framework under FINRA rules. Market participants have raised significant concerns about the Commission's proposed framework for assessing best execution, including concerns around the requirements for "conflicted transactions" with retail customers – which would include transactions subject to exchange rebates – and the need for any Commission-level rule to replace or supplement existing rules and guidance that need be addressed before the Commission moves forward with this rulemaking.

liquidity and provides a rebate for orders that remove liquidity; a low cost or flat fee exchange; an alternative trading system ("ATS"); a single dealer platform ("SDP"); or one of several other kinds of market centers, each with unique pricing structures. If the Commission is concerned with broker conflicts of interest despite existing regulatory obligations, it is not clear how regulation of exchange pricing practices would eliminate those conflicts given inherent variability of pricing across the myriad execution venues available to trade. In addition, while the proposed rule distinguishes between agency-related and proprietary orders on the basis that proprietary orders are not subject to any principal-agent conflicts, the Commission does not explain why orders entered by sponsored customers that similarly choose where their own orders are routed should be treated the same as orders where the broker-dealer exercises routing discretion.

Given the existence of a robust framework for best execution under existing regulations, the lack of any evidence that such framework has been ineffective in mitigating broker conflicts of interest, and the practical impossibility of eliminating inherent routing conflicts through regulation of exchange pricing practices, the Commission should instead focus its efforts on the impact of exchange pricing practices on competition. We therefore turn to this question next. As discussed, our comments focus on exchange competition, which is the market we compete in.

III. CURRENT PRICING MODELS DO IMPOSE A BURDEN ON EXCHANGE COMPETITION THAT THE COMMISSION CAN – AND SHOULD – ADDRESS

Volume tiers offered by national securities exchanges have been likened to standard pricing practices across a range of other industries. For example, incumbent exchange groups that favor preserving the status quo sometimes compare their pricing to stores, like Costco, where members can purchase goods in bulk at a discounted rate, often with larger discounts available for members

that purchase a larger quantity of goods. If Costco and other retailers can offer consumers discounts based on the quantity of goods purchased, the thinking goes, then surely an exchange – an institution at the center of American commerce – can do what amounts to the same thing.

Commissioner Peirce's statement on the proposed rule gets to the heart of this analogy.[17] In it she discusses her large purchases of paper towels from an unnamed bulk goods store. After explaining that "[e]conomies of scale trigger discounts in almost every industry,"[18] she asks the million-dollar question: "Why should similar discounts be unavailable in this industry?"[19] Costco is squarely within its rights to offer discounts to customers that purchase goods in bulk. And prohibiting this practice in the bulk goods context would almost certainly result in higher prices to the detriment of American consumers. Shouldn't the same be true in the U.S. equity markets? Yes!

As discussed, volume-based pricing can be used to promote liquidity provision. This is why MEMX is opposed to a blanket prohibition of such incentives for agency-related orders. However, not all volume-based incentives are the same. The Commission's responsibility under the Exchange Act is to differentiate between incentives that primarily serve to promote robust liquidity and those that serve only to further entrench incumbent exchanges. This is particularly important in a highly-regulated industry where Congress itself has prohibited exchange rules, including pricing schedules, that impose a "burden on competition"[20] that is not "necessary or

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

18 Id.

19 Id.

20 15 U.S. Code § 78f(b)(8).

appropriate"[21] in the furtherance of the purposes of the Exchange Act. Given the Commission's statutory mandate, it must evaluate not only *whether* volume-based pricing ought to be allowed – it should – but also the kinds of volume-based pricing that are necessary or appropriate.

Back to the paper towel analogy. Offering a discount to members that purchase a dozen rolls of paper towels is good for consumers even if it means that some customers pay more and others pay less. In fact, far from imposing a burden on competition, such discounts are evidence of competition at work as retailers compete for customers by offering lower prices to those willing to purchase larger quantities of goods. That said, most consumers would be suspicious of a retailer that based their volume discounts on the member's purchases relative to the total number of paper towels purchased in a month across all retailers, and doubly so if there were ninety-three different price levels for the same roll of paper towel.[22] And if Costco were to operate a natural monopoly for some unrelated goods, tying the price of those goods to the number of rolls of paper towel purchased in a month could, depending on the circumstances, result in an antitrust violation. To ask Commissioner Peirce's question again: why should the U.S. equity market be any different? Millions of customers shop at Costco and benefit from volume-based incentives. If we want a competitive U.S. equities market, perhaps we should learn a thing or two from Costco.

Here are the two most important lessons we can learn from this analogy:

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21 Id.

22 See proposed rule, supra note 1, at 76286 (discussing the number of volume-based pricing levels available at different exchanges).

(1) Volume-based incentives tend to reduce costs for consumers and should be allowed in the U.S. equity market where they can be used to incentivize robust liquidity.

(2) The form of those volume-based incentives is important.

IV. A PATH FORWARD: PROMOTING A ROBUST & COMPETITIVE U.S. EQUITY MARKET BY GENERALLY PROHIBITING TIERS BASED ON TOTAL CONSOLIDATED VOLUME RATHER THAN A FIXED NUMBER OF SHARES

As discussed, volume-based pricing is used across the American economy to facilitate commerce. In the U.S. equity market, this form of incentive can be used promote displayed liquidity, which benefits all investors. At the same time, exchange pricing models have evolved over time to allow incumbent exchanges to "lock in" as much order flow as possible, creating an artificial constraint on competition. As is often the case, the Commission's responsibility here is to balance competing aims. MEMX believes that a rule that generally requires volume-based tiers to be expressed in fixed share amounts appropriately balances the need to promote liquidity provision with the need to promote competition between exchanges. However, as we discuss in the section that follows, tiers based on a percentage of TCV should still be allowed in limited circumstances to protect brokers (exchanges) in an abnormally low (high) volume environment.

Today, volume-based tiers offered by U.S. equity exchanges are typically expressed in terms of a percentage of TCV executed by the member. As a result, the amount of volume required to achieve a tier on a particular exchange fluctuates as industry volumes shift month-to-month. This structure allows exchanges to protect their market share from competition as members must always direct the specified amount of market share to the exchange to qualify for a particular tier. Once the exchange has determined the maximum amount of market share that it can hope to win

from a particular member or group of members, a TCV-based tier allows them to capture that market share more reliably month-to-month even as market conditions or volumes fluctuate.

This structure has also contributed to the sheer number of tiers offered by the largest exchanges. Member market share (expressed in TCV) fluctuates less than member volume (expressed in shares). Using TCV as the metric for establishing tier qualification therefore allows exchanges to more easily target tiers towards a particular member or groups of members. From the perspective of members, this reduces fairness and increases complexity. However, from the perspective of the exchange operator, this allows the largest exchanges to capture the greatest amount of market share possible – i.e., since tier thresholds can be designed to reliably capture all or close to all flow the exchange can hope to win from each member – without having to share those economics with a larger group of firms, which would impact the exchange's profitability.

Of course, smaller exchanges can and do offer similar incentives. However, the effectiveness of tiers based on TCV depends on the market share of the exchange offering the incentive. This is because tiers are retroactive to the first share traded in a month. Falling out of a tier on a larger exchange can be prohibitively expensive for members as the lower rebate or higher fee would be applied to all shares executed by the member during the month. Thus, members may rationally choose to route order flow to qualify for the best tiers on the largest exchanges even where smaller competitors offer better pricing or otherwise provide a more competitive offering.

MEMX therefore recommends that the Commission require that any volume-based transaction pricing offered by a national securities exchange be expressed in a fixed number of shares rather than a percentage of TCV or other industrywide volume measure, except in certain limited circumstances (discussed in the following section) where TCV is used solely to protect

members or the exchange when market volumes deviate significantly from historical norms. Generally prohibiting tiers based on a percentage of TCV, and instead requiring that national securities exchanges use metrics, e.g., a fixed number of shares, that do not vary with industry volumes would limit the opportunity for tiers to be used to "lock in" order flow in an anticompetitive manner. This recommendation would do little damage to the ostensible purpose of existing tiers – i.e., promoting liquidity provision – while addressing competitive constraints, consistent with Section 6(b)(8), which requires that exchange rules "not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the [Exchange Act]."[23]

V. TCV-BASED TIERS SHOULD BE ALLOWED IN LIMITED CIRCUMSTANCES WHEN MONTHLY VOLUMES DEVIATE FROM HISTORICAL NORMS

Tiers expressed as a percentage of TCV can and are used in an anticompetitive manner. However, MEMX is cognizant that there are some benefits to using TCV to promote certainty for both exchanges and their members. Here, a brief history lesson is informative. When exchanges originally adopted volume-based pricing, tiers were expressed in a fixed number of shares. Then, in the aftermath of the 2008 financial crisis, exchanges started experimenting with alternatives based on a member executing a percentage of TCV in order to make it easier for members to achieve their tiers in a declining volume environment. At the same time, competition was on the rise due to a combination of factors, including the Commission's adoption of Regulation NMS, which imposed new order protection requirements, and the introduction of several new independent exchange operators. Eventually, exchanges largely replaced fixed share tiers with TCV-based tiers that allowed them to better insulate their markets from competition. Today, these

[23] 15 U.S. Code § 78f.

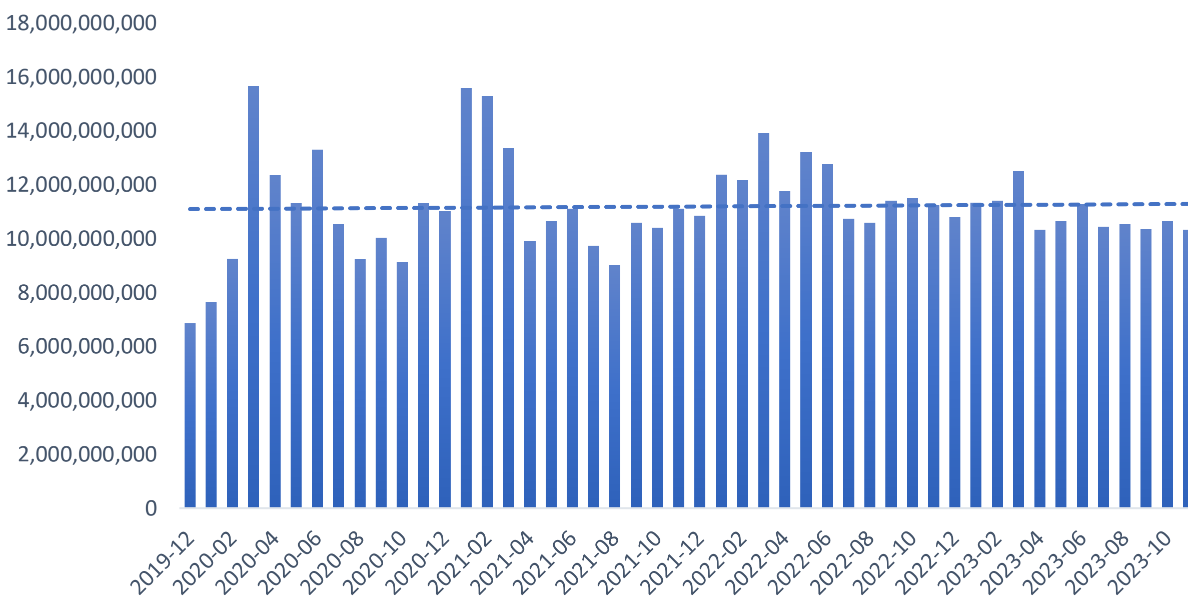
tiers are the norm across all exchanges, including MEMX, as competitive factors make it difficult for any single exchange operator to avoid using pricing tools that are used by competitors.

Although TCV-based tiers have strayed from their original purpose, there may be a place for TCV to be used in limited circumstances. Industry volumes have increased over the past several years. If exchanges moved to a fixed share model and volumes were to suddenly fall below their pre-pandemic levels this could lead to members failing to achieve tiers, similar to the market conditions that resulted in TCV-based tiers being implemented in the first place. Similarly, if volumes were to instead spike again due to unforeseen factors, it is possible that exchanges could find themselves paying out significantly more in rebates then they receive in fees as members unexpectedly achieve tiers with better rates. Thus, to protect both members and exchanges, we recommend that the Commission adopt a framework that allows TCV-based tiers to be used in pre-determined circumstances where volumes are significantly lower or higher than anticipated.

To prevent gaming, i.e., exchanges creating tiers that include a fixed share component that is never or is frequently not determinative of the rate received by the member, the Commission should set specific criteria for an exchange to make use of this limited exception. For example, we believe that it would be fair to allow TCV to be used where monthly volumes rank in the bottom or top tenth percentile across a rolling 48-month period. This would ensure that, for most months, fixed share criteria would be determinative of the fee charged or rebate received by members, while providing flexibility to both the exchange and the member if volumes traded in a particular month are significantly outside of historical norms. This structure would also reduce complexity relative to a structure where each exchange determines these cutoffs on their own as members would know ahead of time when TCV may be used and can plan accordingly – for example, if the

market is calm and volumes are expected to fall significantly, an exchange liquidity provider could determine the likelihood that TCV-based tiers would kick in and route orders accordingly.[24]

Chart 2: Monthly CADV (Dec 2019 – Nov 2023)



10th Percentile: 9.2 billion shares CADV
90th Percentile: 13.4 billion shares CADV

VI. THE COMMISSION SHOULD PROHIBIT ANTICOMPETITIVE AUCTION LINKED PRICING AND/OR ADOPT A LOWER ACCESS FEE CAP THAT APPLIES TO AUCTIONS CONDUCTED BY THE PRIMARY LISTING EXCHANGE

On December 14, 2022, the Commission published a proposed rule to amend various provisions of Regulation NMS, including changes to the minimum increment and a reduction in the Access Fee Cap. Among other concerns, MEMX's comments on the proposed Access Fee Cap

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24 Some existing exchange tiers are expressed in nominal (share) and relative (TCV) terms, and members are therefore familiar with managing these decisions. See e.g. Cboe BZX Exchange, Inc. ("BZX") fee schedule, Add/Remove Volume Tiers. In practice, TCV requirements become relevant once CADV falls below some target, e.g., 10 billion shares.

changes took issue with pricing structures used by primary listing exchanges to tie auction fees to continuous trading volumes, i.e., "auction linked pricing." As we explained in those comments, auction linked pricing is anticompetitive and is used to effectively coerce members into routing their continuous book orders to the primary listing exchange to avoid paying unreasonable, monopoly pricing for trades executed in the closing auction where there is no meaningful competition from other markets.[25] MEMX reiterates the concerns raised in our prior comments and encourages the Commission to address this anticompetitive practice whereby members that route to the closing auction must also trade significant volume during the listing exchange's continuous trading session to avoid unreasonably high fees on their auction volume.

As we detailed in our prior comments, the closing price determined by the primary listing exchange is used as a benchmark for a variety of important purposes – e.g., calculating index and portfolio performance and valuing securities such as mutual funds, exchange traded products ("ETPs"), and derivatives. The closing auction is therefore an important liquidity event for institutional investors whose performance is often measured against this benchmark. However, the closing auction is a virtual monopoly,[26] and the primary listing exchanges are therefore able to charge supracompetitive fees, i.e., fees that are not appropriately constrained by competition.[27] In

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25 MEMX incorporates by reference our comments provided in response to the Commission's December 2022 proposed amendments to Regulation NMS.

26 The closing auction is a unique mechanism that determines the official closing price. Although there are alternative facilities for executing market-on-close ("MOC") orders at the official closing price, these facilities are small relative to the size of the closing auction, may have limited liquidity, and do not support trading using limit-on-close ("LOC") orders that make up a significant portion of closing volume. Only one exchange, BZX, offers a competing MOC facility, and this facility executes a *de minimis* amount of closing volume. The remaining MOC volume is executed off-exchange. See e.g. infra note 29, Appendix.

27 See Staff Guidance on SRO Rule Filings Related to Fees *available at* https://www.sec.gov/tm/staff-guidance-sro-rule-filings-fees (May 21, 2019).

fact, we have previously shown that the blended average net revenue capture for closing auctions conducted by the listing exchanges is as much as seven to fourteen times higher than the more competitive market for continuous trading.[28] Not only is this an issue for institutional investors that have to pay higher fees, it also restricts exchange competition as members must dedicate significant continuous trading volumes – volumes that might otherwise be subject to competition – to the primary listing exchange to avoid the most egregious closing auction pricing.

Again, we reiterate that our concerns here are not theoretical. The primary listing exchanges are already using auction linked pricing to shield their intraday market share from competition. Consider, for example, the closing auction fees charged by Nasdaq. Today, Nasdaq charges a base fee of $0.0016 per share for the execution of MOC or LOC orders in the closing auction. This fee is halved to $0.0008 per share for members that provide more than 1.75% of TCV of liquidity during Nasdaq's intraday continuous trading session – an amount that is larger than the market share of seven of sixteen U.S. equity exchanges, including two Nasdaq affiliates.

Alternatively, consider similar fees charged by the New York Stock Exchange LLC ("NYSE"). After lowering its MOC fees in January 2018 in response to anticipated competition from an alternative MOC facility operated by Cboe Global Markets ("Cboe"), NYSE subsequently raised those fees back to their prior levels when the anticipated competition from that product failed to materialize.[29] These higher fees were then "discounted," with the largest discount applied to members that provide at least 1% of TCV of add volume during NYSE's continuous trading

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[28] See supra note 7.

[29] See Letter from Adrian Griffiths, Head of Market Structure, MEMX to Vanessa Countryman, Secretary, Commission dated February 17, 2022 *available at* https://www.sec.gov/comments/sr-nyse-2022-07/srnyse202207-20116358-267979.pdf.

session. The clear intent of these changes was not to reduce fees for members. In fact, NYSE's fee change had largely the opposite effect – i.e., increasing fees for members that do not qualify for the "discounts." Rather, this change appears to have been structured to reduce competition for continuous trading volumes. As we stated at the time in our comments to NYSE's filing, such blatant attempts for an exchange to leverage market power in a monopoly business to gain a competitive advantage in another business imposes an undue burden on competition. Indeed, we submit that anticompetitive tying of products across market segments is a textbook example of the kind of competitive burdens that Section 6(b)(8) of the Exchange Act was designed to prevent.[30]

As discussed in our prior comment letters, we therefore continue to recommend that the Commission: (1) prohibit "auction linked pricing," defined as a discount or incentive offered by the primary listing exchange on auction (continuous order book) pricing based on continuous order book (auction) volume; and/or (2) subject orders executed in primary listing exchange auctions to a fee cap that is materially lower than the current $0.0030 per share Access Fee Cap.[31]

VII. THE COMMISSION SHOULD BE CAREFUL ABOUT HOW IT INTERPRETS PROPOSED MONTHLY DISCLOSURES FOR VOLUME-BASED TIERS

As discussed, the proposed rule would prohibit volume-based pricing for agency-related orders. Proprietary orders would instead be subject to a disclosure regime that would require exchanges to make monthly disclosures about their tiers. Most importantly, these monthly

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[30] 15 U.S. Code § 78f.

[31] For purposes of our recommendation, an "auction" would be defined as an opening, closing, or halt auction executed on the primary listing exchange. Listing exchanges would be free to utilize volume-based discounts for auctions as long as those discounts are tied to auction volume and not volume executed in the intraday continuous trading session.

disclosures, which would be made within five calendar days following the end of each month, must include information about the number of members that achieve the base rate and each volume-based tier. The Commission often asks for similar information on a confidential basis today when exchanges submit filings establishing or modifying fees. However, the proposed rule would make such information available on a more routine basis and also requires that this information be made publicly available. Although MEMX is typically supportive of increased transparency, we are concerned about statements in the proposed rule release that suggest that the Commission may use such disclosures on their own to determine whether fees are consistent with the statutory standards.[32] Of course, a volume-based tier that is only achieved by one member or a small group of members *could* be unfairly discriminatory depending on the circumstances. However, to understand whether that tier is *actually* unfairly discriminatory necessitates a qualitative not quantitative analysis. Further, it is possible that a smaller or more recently launched exchange may have a significantly different customer base as it attempts to grow market share and compete with larger, more established exchanges. As such, the Commission should be particularly careful not to use its proposed volume tier disclosures in a manner that could negatively impact competition from such smaller exchanges or new entrants to the exchange ecosystem.

Consider the following example. Exchange A has two volume-based pricing tiers. Volume Tier 1 requires that a member execute more than 50 million shares in average daily add volume ("ADAV") in a month and Volume Tier 2 requires that a member executes more than 30 million shares ADAV. As of the end of January, two members qualify for Volume Tier 1 and four members

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[32] For example, the Commission requests comment on whether it would be appropriate to prohibit "tiers for which fewer than 50% of an exchange's members could have met the tier criteria during the prior month" or "tiers for which only one, two, three, or four members are capable of qualifying." See proposed rule, supra note 1, at 76292.

qualify for Volume Tier 2. On February 1, Exchange A files a proposed rule change to introduce New Volume Tier 2, which is intended to encourage members to increase their activity on the exchange. New Volume Tier 2 would apply to members that execute at least 40 million shares ADAV, including at least 5 million shares using a new order type offered by the exchange. When Exchange A files its required disclosure in March, the disclosure reveals that one firm moved from Prior Volume Tier 2 to New Volume Tier 2. Is New Volume Tier 2 unfairly discriminatory?

Only one member qualified for New Volume Tier 2, which the Commission implies may suggest the tier is unfairly discriminatory. However, what if two other members were looking to hit the tier and missed, or are in the process of ramping up their volume with the intention of hitting the tier in March? If one member also fell from Tier 1 into New Volume Tier 2 does that mean New Volume Tier 2 is not unfairly discriminatory but Tier 1 now is since there is only one member achieves that tier in February? What if three members moved from Prior Volume Tier 2 into New Volume Tier 2. Does that mean that Prior Volume Tier 2 is unfairly discriminatory (only one member remaining) but New Volume Tier 2 is not? What if multiple members could hit New Volume Tier 2 but have instead decided to route their order flow to a larger exchange to qualify for that exchange's volume tiers, which come with higher volume requirements? How would the Commission account for broker-dealer concentration or different member counts across exchanges, both of which could impact the number of firms that qualify for a tier?

We submit that these question are inherently unanswerable without more information and any attempt to shoehorn what should be a qualitative analysis into a simple quantitative standard would do more harm than good. Thus, while MEMX is not opposed to additional transparency around exchange volume tiers, the Commission should be careful about how it uses those disclosures and not presume that such disclosures alone are sufficient to determine whether a fee

meets the Exchange Act standards or that a specific numeric result (e.g., one member qualifying for a particular tier) is *de facto* evidence that a volume tier is inconsistent with such standards.

VIII. THE PROPOSED RULE IS INTERRELATED WITH THE COMMISSION'S DECEMBER 2022 PROPOSED AMENDMENTS TO REGULATION NMS

Finally, the proposed rule is interrelated with the Commission's December 2022 proposed amendments to Regulation NMS in at least two ways. First, the impact of the proposed rule will depend on the kinds of tier structures included in the regulatory baseline. One potential impact of the proposed reduction in the Access Fee Cap is a similar reduction in the number of pricing tiers on each exchange, as a $0.0005 or $0.0010 fee cap implies significantly flatter fee schedules given the more limited number of available price points. It is difficult to predict the potential impact of prohibiting volume tiers for agency-related orders without knowing what tiers would look like under a lower Access Fee Cap or even the level of fees that the Commission may choose to permit under its proposed amendments to Regulation NMS. MEMX's comments are predicated on the Commission continuing to permit an access fee of $0.0030 for most symbols.[33] If that's not the case, MEMX and other market participants should be given an additional opportunity to comment on the proposed rule based on the actual content of any final rule amending the Access Fee Cap. Second, the proposed amendments to Regulation NMS contain language that requires that fees be "determinable at the time of execution."[34] Such changes may no longer be relevant if the Commission adopts the proposed rule as agency-related orders would not be subject to tiers. More

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[33] As we stated in our comments to the proposed Regulation NMS amendments, MEMX believes that Access Fee Cap changes should be limited to a commensurate reduction in the Access Fee Cap to $0.0015 per share in tick constrained NMS stocks that we recommend be allowed to trade in a half penny increment. See supra note 7.

[34] See supra note 6.

broadly, we encourage the Commission to consider each of its five proposed equity market structure rules wholistically instead of requiring interested market participants to guess as to the ultimate changes the Commission may choose to make and how those decisions impact their assessment of the potential costs and benefits of any new regulation being considered.

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MEMX thanks the Commission for the opportunity to comment on the proposed rule. Although we share some of the Commission's concerns around the impact of exchange pricing practices on competition, we are concerned that the proposed rule is too blunt of an instrument to address those concerns. Such broad changes to exchange pricing structures will come at a cost, including a cost to liquidity that the Commission has not considered in its cost benefit analysis. Rather than a blanket prohibition on volume-based pricing, we recommend that the Commission consider more limited changes to the kinds of volume-based pricing structures that exchanges are allowed to use, including changes that address the use of TCV in exchange pricing schedules and the anticompetitive tying of monopoly auction fees to intraday continuous trading volumes.

Regards,

/s/ Adrian Griffiths

Adrian Griffiths
Head of Market Structure