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Via Electronic Submission

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

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

Dear Ms. Countryman:

Cboe Global Markets, Inc. and its subsidiary securities exchanges (collectively “Cboe”)¹ appreciate the opportunity to comment on the above-referenced proposed rule change (“the Proposal”) issued by the Securities and Exchange Commission (“SEC” or “Commission”).² If adopted, the Proposal would impose price controls that prohibit national securities exchanges from offering their members volume-based transaction pricing in connection with the execution of agency or riskless principal orders in NMS stocks (“customer orders” or “agency-related volume”). The Proposal would also require equities exchanges that have volume-based transaction pricing for member proprietary volume to implement anti-evasion policies and procedures, and disclose to the SEC, monthly, the number of firms that qualify for each pricing tier. The SEC would then make this information available to the public via EDGAR.

As a leading provider of global market infrastructure and tradeable products, and a prominent U.S. equities exchange operator, Cboe is well positioned to provide comments on the Proposal. Cboe supports the Proposal’s stated goal to facilitate investor protection and the public interest while enhancing competition. We cannot, however, support this specific Proposal or fee setting by the Commission more broadly.

Regulatory intervention of exchange fees would negatively impact competition between exchanges, as well as between exchanges and non-exchange trading venues by limiting an important competitive tool – tiered rebates. Exchanges regularly use rebate tiers to foster liquidity

¹ Hereinafter, all references to Cboe are in reference only to Cboe Global Markets, Inc.’s, U.S. equities exchanges that trade National Market System (“NMS”) stocks: BZX Exchange, Inc., BYX, Exchange Inc., Cboe, EDGA, Inc., and Cboe EGDG, Inc.

² Securities Exchange Act Release No. 98766 (October 18, 2023), 88 FR 76282 (November 6, 2023) (“Volume-Based Exchange Transaction Pricing for NMS Stocks”).

and encourage the submission of orders to the lit public markets. Those orders can come from a variety of sources including broker-dealers, retail investors, institutional investors, and buy-side investors (i.e., those that invest money on behalf of others, such as pension funds and investment managers). Prohibiting rebate tiers would only serve to further disadvantage exchanges seeking to compete in a marketplace where increasingly more and more order flow is executed off-exchange.

It would also likely fail to enhance competition between brokers (contrary to SEC assumptions) given the myriad of factors that drive competition between brokers aside from rebates. Perhaps more importantly, the Proposal risks imposing higher costs on investors, given that by reducing the overall rebates awarded for the execution of agency order flow, it will increase costs for brokers and implicate the economics they offer to end-user customers. For example, when an exchange member attains a certain rebate tier at Cboe, the resulting cost savings may then flow down the transaction chain to investors (i.e., many retail investors enjoy commission-free trading). Indeed, a consequence of eliminating such cost-savings, as acknowledged by the Commission, may be that broker-dealers increase trading commissions, thereby resulting in *increased* costs for customers.³ Moreover, the Commission also posits that costs *could* go down for investors, but fails to provide quantitative data or concrete evidence to support that notion.

The Proposal also would unnecessarily add to the already robust regulatory framework in place for national securities exchanges. Unlike the off-exchange venues with which national securities exchanges compete, exchanges are subject to transparency and reporting requirements, as well as an extensive and often lengthy rule filing process that shapes how and when exchanges may offer its members innovative trading solutions necessary to attract trading volume. Off-exchange venues also offer features today that exchanges cannot offer, such as capital commitment to customer orders, targeted indications of interest, order segmentation designed to increase fill rates and improve parent order level performance, and greater anonymity – not to mention a regulatory framework that enables off-exchange venues to more quickly introduce new innovations. This competitive dynamic has left registered exchanges with an increasingly smaller share of the overall equities market and limited tools with which to compete. One important tool that exchanges rely on to be able to compete with other trading venues are volume-based rebates, which allow exchanges to attract orders and in turn directly result in lower costs, narrower spreads, and more liquidity for investors. Indeed, in recent years, a growing share of U.S. equity volumes have migrated to off-exchange venues that are less regulated and transparent than exchanges. In 2023, 43.23% on average of consolidated volume was traded off exchange, up from 16% a decade ago.

Ultimately, prohibiting national securities exchanges from offering volume-based transaction pricing for customer orders will reduce exchanges' ability to compete. Cboe believes a likely consequence will be more volume migrating to off-exchange market centers. In turn, by encouraging shrinkage of the lit market, the Proposal has the potential to harm price formation, degrade on-exchange liquidity, increase trading costs, and negatively impact the overall universe of exchange members. Indeed, the Commission acknowledges the likelihood of this in its Proposal:

“Either (1) total order flow across exchanges may decrease or (2) a portion of that flow moves off-exchange, which in turn would harm on exchange liquidity and increase trading costs. Applying the insights from the price discrimination literature to the exchange setting

³ See Proposal at 76318.

suggests that the proposed ban on volume-based pricing may decrease both overall order flow across exchanges and overall efficiency, defined in terms of profit summed across broker-dealers and the exchanges.”⁴

In other words, prohibiting tiered pricing will negatively impact *both* exchanges and broker-dealers. We are troubled by this result and respectfully urge the SEC to abandon the Proposal.

In this letter, we highlight why the Proposal would hinder instead of foster competition, explain how it would implicate costs for end users, and detail our objection to regulatory intervention of exchange pricing.

Summary

The Proposal should be abandoned given its costs heavily outweigh its perceived benefits, and because it:

- Is unlikely to significantly change competitive dynamics between broker-dealers, given existing business arrangements are based on a variety of considerations well beyond rebates.
- Will hurt competition between exchange venues, as tiered incentives are a primary tool utilized by exchanges to differentiate their offerings from their peer exchanges.
- Will negatively impact exchanges’ ability to compete with off-exchange venues – which already hold key competitive advantages over exchanges – by denying exchanges the ability to incentivize market participants to execute their orders on-exchange.
- Will likely increase costs for investors in many ways, including by taking away higher rebates that can result in costs savings for investors.
- Assumes conflicts of interest are rampant but fails to show evidence that volume-based fees are impeding brokers’ ability to satisfy their obligations or harming investors; and inappropriately aims to manage potential *broker* conflicts by restricting *exchanges*. Indeed, there are existing rules in place that are more appropriate mechanisms for the Commission and other self-regulatory organizations to address any potential broker conflicts of interest such as FINRA Rule 5310.
- Is inconsistent with congressional intent. Congress established an entirely distinct regulatory filing process for exchange pricing that, by law and applicable rule, requires exchange fee changes to become effective immediately and can only afterward be suspended by the Commission. Congress did not bestow the SEC with the authority to set exchange pricing by government writ.
- Is inconsistent with existing anti-trust law and precedent that have been developed by the courts.
- Fails to conduct an adequate cost-benefit analysis, and instead primarily aims to show data in support of a pre-determined preferred outcome (to ban rebate tiers for customer orders) while only briefly acknowledging, but not estimating, its costs.
- Fails to make the case that rebates are inconsistent with the Securities Exchange Act of 1934 (the “Act”).

⁴ See Proposal at 76321.

Instead, we urge the Commission to consider a study of the issues and collect relevant information as needed. For instance, the Commission could request information about the arrangements in place between higher-volume and lower-volume broker-dealers. The Commission itself notes it is not familiar with the specifics of certain broker-dealer arrangements, such as the extent to which sponsoring members may pass on rebates to their clients.⁵ It would seem more prudent, particularly in the face of a proposal with benefits that are, at best, aspirational, to first gather all relevant data and information before engaging in a major overhaul that is more likely to have negative consequences for exchanges and others to the detriment of investors. A “do no harm” approach must inform all market structure rulemakings.

1. The Proposal is unlikely to help competition between broker-dealers the way the SEC envisions.

One of the main concerns the Commission seeks to address through its Proposal is the possibility that volume-based exchange pricing negatively impacts competition among exchange members. The Commission is concerned that members with lower exchange volumes are not always able to qualify for exchanges’ more favorable volume-based exchange transaction pricing tiers (i.e., lower costs or higher rebates) that are sometimes earned by high-volume members. As a result, the Commission believes that lower-volume broker-dealers are less able to compete with higher-volume broker-dealers for order flow because they are unable to pass through to customers the favorable transaction pricing or lower commissions enabled by rebate tiers.

Cboe strongly disagrees with the Commission’s apparent belief that prohibiting volume-based tiers for agency-related volume will help lower-volume members better compete with higher-volume members.

While many members, including lower-volume broker-dealers, do not always qualify for an exchange’s most favorable volume-based transaction pricing, it is Cboe’s belief that such broker-dealers indeed *benefit* from the cost savings and access to technology provided to them by routing through higher-volume broker-dealers. For instance, rather than having to invest capital to build the technology infrastructure to support their agency-related volume, smaller broker-dealers can choose to utilize smart order routers, trading algorithms, and market access connections offered to them by higher-volume broker-dealers. What’s more, in certain arrangements these services may be white labeled (i.e., the smaller broker-dealer is able to sell the service offered by the high-volume member but with their own brand). The benefit of such arrangements for smaller broker-dealers is that higher-volume broker-dealers can offer scaled pricing, often reducing the costs of such services and providing them access to capabilities they do not maintain internally. Additionally, high-volume broker-dealers may offer smaller-volume brokers-dealers bundled services with their execution offering, such as research.⁶ In turn, lower-volume broker-dealers can choose to spend resources to leverage their individual strength, which may “lie in good research in a niche area or personal attention, which contributes to a firm’s perceived service quality.”⁷

⁵ See Proposal at 76286.

⁶ Id at 76313.

⁷ Id at 76317.

The Commission, however, attributes these beneficial arrangements to an unfair competitive advantage enjoyed by higher-volume broker-dealers who qualify for exchanges' highest volume tiers, and in turn pass on earned costs savings and rebates to their customers. This viewpoint fails to acknowledge that technology, infrastructure, and connectivity costs are a significant monetary investment and require significant human expertise and resources to maintain. The Commission ignores the fact that lower-volume broker-dealers may *deliberately* choose to rely on services provided by higher-volume broker-dealers. Firms choose to forego the significant capital contributions necessary to develop and implement a trading infrastructure, as well as retaining the expert personnel needed to build and maintain such technology.

The Commission's premise also neglects to consider that many of the higher-volume broker-dealers forming part of their concern are large, multinational, corporate investment banks, generating profits from not only equities transactions, but execution services for multiple asset classes, corporate banking, capital markets transactions, research, and securities lending, amongst others. Exchange rebate tiers do not change the fundamental reality that a large investment bank's ability to attract customer order flow and develop and implement trading infrastructure is and will continue to be many times greater than that of a lower-volume broker-dealer.

While higher-volume broker-dealers may more easily qualify for an exchange's best pricing tiers, it would be inaccurate to attribute the discrepancy between higher-volume broker-dealers and lower-volume broker-dealers to this fact alone. Indeed, the Commission acknowledges that several factors have contributed to increased concentration in the executing broker industry,⁸ noting that "broker commission pools and rates have long been in decline" and that as "some broker-dealers have become more efficient through automating most trades, competition for customers forced other broker-dealers to streamline or offer price cuts."⁹ Over the past 15 years, several large firms have consolidated (e.g., Merrill Lynch into Bank of America, Credit Suisse into UBS, Lehman Brothers into Barclays, Bear Stearns into JP Morgan) due to reasons other than exchange tiers. Therefore, it is not clear why exchange tiers and pricing are a focus given there are other sizable aspects driving the competitive dynamic in the broker-dealer industry.

The Proposal also presupposes that if the proposed prohibition removes any transaction pricing "advantages" enjoyed by higher-volume broker-dealers, that lower-volume broker-dealers will be ready to step in and offer customers the same trading capabilities. And yet, in reading the Proposal it is clear that the Commission itself is not entirely sure if that will be the case, or what impact prohibiting volume-based tiers may have on the equities markets. What is more, the Commission concedes that higher-volume broker-dealers are generally more efficient in certain regards, and that tiered pricing may in fact have a positive impact on today's equities markets:

"Tiered rebates that aid in the concentration of order flow among high-volume exchange members may be desirable from an allocative efficiency perspective. Due to their scale economies, the high-volume exchange members may have technology, capital or service strengths arising from their scale economies.

⁸ Id. at 76313.

⁹ Id.

Directing order flow to the high-volume exchange members may better ensure that resources are utilized in a cost-effective manner. Conversely, under the proposed ban on volume-based pricing, dispersing order flow across broker-dealers may reduce allocative efficiency.”¹⁰

It should also be kept in mind that members have differing business models (e.g., agency broker-dealers versus market-makers/liquidity providers), manage and handle different types of order flow, and have different investment benchmarks, which may make certain tiers appealing or unappealing, thus dictating whether they choose to try and satisfy certain tiers. There are also a host of other factors that influence trading decisions that impact whether a member can satisfy the requirements for a tiered rebate. For instance, members may choose (or not choose) to route their order flow to a particular exchange due to changes in their underlying routing strategy, better priced liquidity, better fill rates, or due to an overall depression in trading volumes resulting from macroeconomic events that drive trading. Notably, investors are increasingly routing their orders to non-displayed market centers such as alternative trading systems (“ATs”) and principal broker-dealers, particularly where such venues offer segmentation or conditional order types that may help to enhance investor parent level order performance. As such, whether a member adds the requisite volume required by tiered rebates is dependent on many factors, and it is inaccurate to attribute certain members falling short of volume thresholds to some sort of favoritism afforded to higher-volume broker-dealers.

From a more principled perspective, it is troubling that the Commission has deemed it appropriate to impose upon the equities markets its narrow and subjective view of “fair” competition, rather than allowing sophisticated, corporate entities to compete based on the merits of their product offerings, expertise, and consequences of their business decisions. The Commission seemingly views as unfair the fact that certain broker-dealers have committed capital to develop technology infrastructures to support their trade offerings, hire and retain experts in the field of trading and technology, and attract customer order flow. Indeed, in almost all other marketplaces, there exist “big” and “small” businesses, where “big” businesses attract a significant majority of consumers, and “smaller” businesses often compete through niche offerings, or business models designed to attract a certain segment of the customer base. Above all, it is not clear why the Commission is tasking exchanges with the responsibility of ensuring lower volume broker-dealers can compete with higher-volume broker-dealers when attracting investors. The merits of such a position are contrary to healthy competition.

2. The Proposal will actually hurt competition between venues by taking away an important competitive tool.

Today’s marketplace is highly competitive, and investors have access to a variety of trading venues beyond the 16 national securities exchanges trading equities. These off-exchange trading venues include ATs, electronic liquidity providers (“ELPs”), central risk books (“CRBs”), single dealer platforms (“SDPs”), and wholesale broker-dealers, amongst others, which in aggregate, accounted for 43.6% of continuous trading volume in November 2023.

¹⁰ Id at 76318.

For an exchange to compete effectively, it needs to differentiate itself and offer a compelling reason for order flow to be routed there. Rebate tiers are an important mechanism in that regard, as exchanges can use volume-based pricing tiers to compete for order flow with off-exchange market centers. Banning this important competitive tool risks accelerating the shrinking of the addressable market for which exchanges compete today. This is particularly concerning given that execution pricing in many off-exchange market centers is reliant on the lit market bid/ask.

Additionally, the Commission suggests that the elimination of volume-based tiers would benefit markets by prohibiting the primary listing exchanges from tying discounted closing auction fees to a member's intraday trading volume. However, this will not have the intended impact of improving competition between exchanges. Instead, Cboe believes that the proposed prohibition will likely cause immediate price increases for the marketplace overall. With the elimination of intraday rebate tiers, the primary exchanges will be less incentivized to discount their closing auction fees, and the agency flow currently benefiting from discounted closing auction fees will likely no longer be able to receive that benefit. Moreover, given that agency flow makes up a substantial portion of closing volume, it is likely that tiers for closing auctions will disappear entirely. This will likely raise the costs of closing transactions for investors and other market participants, and result in a significant financial windfall to the primary exchanges.

While exchange-driven alternatives to the closing auctions do exist, they are not likely to serve as fungible alternatives to the primary auctions without holistic industry buy-in. Because the primary exchanges provide closing auctions for their listed securities, they will likely remain the obvious means for investors to get their trades executed at the official closing price. Therefore, with the continued aggregation of closing volume at the primary exchanges, investors will be forced to give up a cheaper transaction for a more expensive one.

Further, non-primary exchanges will be disadvantaged as they will not have high-fee auction volumes to offset lost intra-day volumes. Cboe notes that the primary exchanges typically limit additional closing auction discounts to market-on-close ("MOC") order types (rather than limit-on-close order types) in efforts to compete with the growth of alternative MOC mechanisms¹¹ offered by broker-dealers. In this regard, prohibiting rebate tiers for agency-related order flow may divert more MOC orders to off-exchange offerings thereby limiting the primary exchanges' ability to compete with these venues.

Cboe also urges the Commission to consider the anti-competitive effects the proposed prohibition will have between exchanges in terms of order flow and revenue. As acknowledged by the Commission, exchanges such as Cboe stand to suffer a decrease in net transaction revenue. While it is not the Commission's mission to protect an exchange's revenue, it would be imprudent for the Commission to ignore the magnitude of how its Proposal may negatively impact exchanges. Specifically, as of September 2023, of all the members receiving a tiered rebate on Cboe, nearly 40% of tiered rebates were received in connection with agency-related volume. The volume associated with achieving such rebates is important both in terms of equities market share and Cboe's revenue generation. Ultimately, the proposed ban would decrease Cboe's net transaction

¹¹ For instance, several broker dealers offer functionality that matches un-priced orders and crosses them at the security's official closing prices, as determined by the closing auction at the primary exchange for a security.

revenue, and with it, our ability to compete with other venues, as well as our ability to commit resources toward the development of investor-centric trading solutions that are essential to maintaining a healthy, and quality marketplace.

3. The Proposal will likely increase costs for investors.

In addition to not improving competition between exchange members and harming competition between venues, the Proposal will more than likely increase costs for all market participants involved in the chain of agency-related orders submitted to exchanges. In general, increased exchange volume enables exchanges to offer richer rebates that reduce transaction costs to members. These members can then pass on the benefit of these economics to their end clients. By removing a less costly trade from broker-dealers, their costs will increase. Moreover, the enhanced liquidity fostered by rebates directly result in lower costs, narrower spreads, and more liquidity for investors, including lower-volume broker-dealers. Collectively, breaking this chain makes it increasingly *less* likely that end users' costs will decrease, or even remain the same. Notably, the Commission itself acknowledges the likelihood of increased transaction costs stemming from the proposed ban.¹²

The Commission's related "benefits" analysis for lower-volume members does little to mitigate the deleterious impact that the prohibition will have on investors' trading costs. In fact, most of the benefits to lower-volume members noted by the Commission are theoretical in nature, with the Commission noting only *potential* benefits. Because the benefits contemplated by the Commission are not as certain as the existing cost-savings and benefits provided to lower-volume members by higher-volume members, it is critical that the Commission consider precisely whom this Proposal will benefit, and why the Commission deems it prudent to replace existing low-cost transactions with theoretical outcomes. Indeed, if the Commission's primary mandate is to protect and help investors, it is not clear how the Proposal furthers the Commission's goal. In simplest terms, *this proposal is eliminating cost savings that benefit market participants and investors* – an odd objective for a government agency.

4. The Proposal is inconsistent with competition antitrust law and goes against conventional legal thinking.

Through its Proposal, the Commission seeks to address its concerns that volume-based rebate tiers for agency-related volume are harmful to competition between exchanges and between exchange members. Cboe strongly disagrees. Despite the use of "buy more, pay less" incentives in other areas of commerce, as well as compelling U.S. case law supporting the view that rebate tiers are *not*, at a minimum, per se anticompetitive, and are actually "pro-competition," the Commission instead seeks to narrowly define what should constitute "competition" in the U.S. equities markets.

Tiered rebates are legitimate business tools that allow businesses to compete with one another by effectively lowering prices to increase sales – i.e., lowering transaction costs (prices) to help induce market participants to execute volume on an exchange (increase sales). Rebate tiers are used widely by an array of industries, including retail, construction, distribution, airline, manufacturing, and

¹² See Proposal at 76321 and 76328.

electrical, to name a few. In these industries tiered rebates are typically used to offer customers cash back on their purchase or consumption price of a good or service, or to incentivize customers to continue transacting with a particular company. Similar to the U.S. equities exchanges, many of these industries are subject to strenuous regulation and are still permitted by their regulators to utilize rebates to attract customers.

Importantly, at law, pricing incentives designed to reduce prices have consistently been held by the U.S. courts to be beneficial to the marketplace and the very “essence of competition.”¹³ Indeed, great protection has been afforded to such pricing mechanisms by the U.S. courts in order to prevent unnecessary regulation that would “chill the very conduct that the antitrust laws are designed to protect.”¹⁴

Therefore, it is unclear why exchanges’ volume-based rebate tiers –which are competitive tools– should be prohibited in the U.S. equities markets. Deep liquidity pools and transparent pricing are critical to ensuring efficient transactions and the best prices. A key component to fostering robust liquidity, though, is the ability to attract volume. Just as many industries have permissibly innovated to offer customer inducements to consume more and pay reduced prices, equities exchanges have sought to induce volume by offering tiered rebates for achieved levels of executed volume. The courts have endorsed the benefits of this competitive construct.¹⁵

¹³ See Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, (1986) (“[C]utting prices in order to increase business often is the very essence of competition.” In this often-cited Supreme Court case, US-based television manufacturers alleged that Japanese television manufacturers conspired to sell television sets in the US at artificially low prices in an effort to drive US television manufacturers out of business. The plaintiffs sought to establish the conspiracy “through evidence of rebates and other price-cutting activities” by the Japanese television manufacturers. The Supreme Court denied the claim, pointing out that price cutting is procompetitive, not anticompetitive, and that courts should be very careful not to issue rulings that chill such price cutting.

¹⁴ Id.; see also, Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227 (1st Cir. 1983) (“[L]ower prices help consumers. The competitive marketplace that the antitrust laws encourage and protect is characterized by firms willing and able to cut prices in order to take customers from their rivals...Thus a legal precedent or rule of law that prevents a firm from unilaterally cutting its prices risks interference with one of the Sherman Act’s most basic objectives: the low price levels that one would find in well-functioning competitive markets.”); see also, In re EpiPen (Epinephrine Injection, USP) Mktg., Sales Prac. & Antitrust Litig., 44 F.4th 959 (10th Cir. 2022), cert denied sub nom. Sanofi Aventis U.S., LLC v. Mylan Inc., 143 S. Ct. 1748 (2023)(citing Matsushita, supra, the court found that rebating “exemplified vigorous price competition - something we strenuously protect.”); see also, Brooke Grp. Ltd. V. Brown & Williamson Tobacco Corp., 509 U.S. 209, 113 S. Ct. 2578, 125 L. Ed. 2d 168 (1993) (“[W]e have rejected elsewhere the notion that above-cost prices that are below general market levels or the costs of a firm’s competitors inflict injury to competition cognizable under the antitrust laws.”).

¹⁵ See Virgin Atl. Airways Ltd. V. Brit. Airways PLC, 257 F.3d 256 (2d Cir. 2001) (“...’the use of corporate deals and [travel agent commission overrides] can be a natural and desirable consequence of competition among airlines for corporate and travel agent business.’ These kinds of agreements allow firms to reward their most loyal customers. Rewarding customers promotes competition on the merits.”). This case is particularly on-point to the matter at hand. British Airways offered volume discounts to companies and travel agents that made volume purchases of flights between the UK and the US. As with exchanges’ tiered rebates, the volume discounts were awarded when specified thresholds of sales were reached, and British Airways retroactively applied the higher discount levels to all the customer’s sales once the higher sales target was met. Virgin Atlantic challenged the program as anticompetitive. The court found that there was no showing

As noted, rebates are key competitive tools that enable exchanges to attract liquidity, and compete not only with exchanges, but off-exchange venues. However, the Commission has deemed such well-accepted economic behavior as anticompetitive and offered no clear justification for doing so. The proposed ban, if implemented, would be contrary to business practices that are quintessentially pro-competition and would unjustifiably distinguish investors and participants choosing reduced transaction costs offered through exchange rebates from consumers seeking to fly their favorite airline for a reduced fare.

5. **The Proposal assumes conflicts of interest are rampant with no evidence and contradictory assumptions.**

One of the stated concerns motivating this Proposal (besides competition) is the presence of potential conflicts of interest among brokers. It is widely understood that *potential* conflicts of interest are commonplace in the financial industry. Conflicts of course need to be managed appropriately, but there is scant evidence that volume-based exchange fees are harming investors or causing brokers to ignore their obligations to investors. Even if we were to assume that unmanaged conflicts associated with volume-based exchange fees are rampant, Cboe believes it is entirely inappropriate for the SEC to manage *broker* conflicts by restricting *exchanges*. To the extent the Commission is concerned about broker conflicts, we believe the appropriate response is to address those concerns with brokers rather than exchanges. Banning a longstanding exchange practice that enables exchanges to compete for order flow would not address the source of the perceived problem.

Fundamentally, however, we do not believe the Commission makes a strong case in its Proposal about the existence of conflicts of interest. In the Proposal, the Commission mentions various types of perceived conflicts the ban would hypothetically solve but elsewhere in the Proposal the facts presented are contradictory.

For instance, one kind of conflict of interest the Commission notes is that some members receiving benefits from tiered exchange pricing may not always pass through these benefits to customers and retain the benefit for themselves. Setting aside the fact that the Commission does not include any data or analysis to support this claim, elsewhere in the Proposal, the Commission writes about how high-volume exchange members do pass through better exchange pricing to customers, which allows them to outcompete lower-volume exchange members for customers.¹⁶ In other words, the Commission is acknowledging that some exchange members do in fact pass through benefits to customers.

It is also noteworthy that the Commission describes how customers have an elastic demand for the services they receive – meaning a price difference can change their preferences. The Proposal notes, “broker-dealers may be motivated to offer lower commission fees or partially pass through their transaction price advantages, in part because certain classes of investors are sensitive to

that volume discounts had an adverse effect on airline passengers and that there was a procompetitive justification for the rebates as a loyalty program.

¹⁶ See Proposal at 76313-76314.

changes in their trading costs or cum-rebate commission rates.”¹⁷ It follows, then, that a proposed rule change that would substantially change the economics for customer orders, would also substantially change the demand from customers, which is likely not the Commission’s intended impact.

Another type of conflict of interest discussed is the idea that the desire to qualify for volume-based transaction pricing tiers incentivize members to improperly route customers order to a particular exchange to achieve volume tiers on that specific exchange. A similar one is that the routing decisions a member makes with respect to its agency-related order flow can also benefit its unrelated proprietary business. To the extent routing decisions are consistent with FINRA Rule 5310, it is not clear why it is concerning that the proprietary side of a business is deriving some benefit from its overall business practices.

FINRA Rule 5310 requires broker-dealers to exercise reasonable diligence to ascertain the best market for a subject security and buy or sell in such market so that the resultant price to their customers is as favorable as possible under prevailing market conditions. Rule 5310 also requires brokers to conduct either order-by-order reviews or “regular and rigorous” reviews of the execution quality of customer orders. In addition, the SEC has also proposed its own best execution rule, which would establish a federal best execution standard requiring, amongst other things, broker-dealers to implement policies and procedures for conflicted transactions and document their compliance with the best execution standard. Given this particular type of conflict of interest is already the singular focus of existing and proposed rules, enforcement of those rules is certainly the most effective tool to deal with this type of conflict of interest.

Ultimately, while the Proposal mentions “conflict of interest” dozens of times, Cboe is not convinced that volume-based fees inhibit firms from upholding their obligations and duties to investors, which is the risk that arises from conflicts of interest. In fact, existing exchange pricing schedules align incentives exceptionally well, enabling member firms to pass on lower costs for investors. The Commission would be hard pressed to suggest that increasing investor costs is the way to address conflict of interests.

6. The Proposal fails to uphold congressional intent.

The proposed ban of volume-based transaction pricing for customer orders not only moves in opposition to the SEC’s mission but also no longer upholds Congress’ intent.

Congress passed the Securities Exchange Act of 1934 with a clear intention: to protect investors and public interest. In authorizing the formation of the SEC, the Act very explicitly laid out the responsibilities that would help the Commission achieve its purpose including disciplinary powers and authority over certain matters.

Notably absent from the set of responsibilities Congress bestowed on the SEC was the authority to set exchange pricing by government writ. In fact, Congress set up an entirely different process for exchange pricing that, *by law* and applicable rule, requires exchange fee changes to become

¹⁷ Id at 76313.

effective immediately and can only afterward be suspended by the Commission. In other words, Congress did not intend for the SEC to unilaterally set exchange pricing schedules. The Commission acknowledges its post hoc authority to suspend exchange fee changes but suggests that the Proposal is necessary to address similar pricing on multiple exchanges.¹⁸

We strongly disagree with the assertion that the post hoc approach does not allow the SEC to address pricing across exchanges. The SEC reviews every fee filing and has the ability to suspend similar proposals from different exchanges. Every rebate tier in place on a national securities exchange today has been reviewed and allowed by the Commission. More important, however, is that the existence of similar pricing across multiple exchanges does not give the SEC authority to circumvent congressional intent, which is exactly what this rulemaking represents – an attempted circumvention of existing, congressionally mandated authority.

Volume-based pricing is not a new concept and has long existed in the exchange space, as well as markets for other goods and services. There is a legislatively mandated mechanism for objecting to exchange fee proposals; notably when they are first introduced and the Commission has an opportunity to suspend, as set forth in the Act. We posit that this is because regulators and policymakers alike intuitively or consciously agree that variable and flexible pricing enables exchanges to compete and offer liquid markets with lower costs for investors and for the benefit of public interest. Indeed, over the years, the Commission has repeatedly expressed its preference for competition over regulatory intervention in determining prices, products, and services in the securities markets. In adopting Regulation NMS, for instance, the Commission highlighted the importance of market forces in determining prices and self-regulatory organization (“SRO”) revenues, noting how the current regulation of the market system “has been remarkably successful in promoting market competition in its broader forms that are most important to investors and listed companies.”¹⁹ Indeed, the fact that the equities markets are competitive has long been recognized by the courts. For instance, in *NetCoalition v. Securities and Exchange Commission*, the D.C. Circuit stated:

“[n]o one disputes that competition for order flow is ‘fierce.’ ... as the SEC explained, ‘[i]n the U.S. national market system, buyers and sellers of securities, and the broker-dealers that act as their order-routing agents, have a wide range of choices where to route orders for execution’; [and] ‘no exchange can afford to take its market share percentages for granted’ because ‘no exchange possesses a monopoly, regulatory or otherwise, in the execution of order flow from broker dealers’ ...”²⁰

Today, Cboe continues to operate in a highly competitive environment with more than a dozen other registered exchanges and 87 distinct off-exchange venues (ATs and principal dealers). Limiting exchange pricing and flexibility with respect to volume-based rebates for customer orders is not consistent, and in fact is in direct opposition to congressional intent.

¹⁸ Id at 76285.

¹⁹ See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37499 (June 29, 2005) (“Regulation NMS Adopting Release”).

²⁰ See *NetCoalition v. SEC*, 615 F.3d 525, 539 (D.C. Cir. 2010) (quoting Securities Exchange Act Release No. 59039 (December 2, 2008), 73 FR 74770, 74782-83 (December 9, 2008) (SR-NYSEArca-2006-21)).

7. The Proposal's economic analysis is insufficient and flawed.

The Proposal also fails to conduct an adequate cost-benefit analysis. Rather than an exploration of costs and benefits, the section primarily aims to show data in support of a pre-determined preferred outcome (to ban rebate tiers for customer orders) and only briefly acknowledges but does not estimate the costs. Indeed, much of the Proposal is premised on the idea that the benefits are a given and the costs are minimized.

Notably, in terms of costs, the Commission correctly recognizes²¹ that banning rebate tiers for customer orders will:

- Lead to market shrinkage, fragmentation, and migration to off-exchange venues, decreasing total order flow across exchanges, harming on-exchange liquidity, and increasing trading costs;
- Harm broker-dealers and exchange members (i.e., increase transaction costs);
- Widen NBBO spreads and make the search for best price more costly for the remaining participants (both agency and principal) on the exchange;
- Lead to efficiency loss (i.e., directing more order flow to the lower-volume exchange members might result in resources being inefficiently utilized, as high-volume exchange members might be most efficient at executing trades due technology, capital or service strength arising from their scale economies); and,
- Distort the market (i.e., increase the dispersion of agency flow and increase the concentration of principal order flow across exchanges)

In reviewing the rest of the economic analysis section to verify the assumptions and data interpretations underpinning the Proposal, however, we identified several significant concerns.

In particular, the Proposal assumes causality without showing evidence to support its claims, including a cause-effect relationship between rebates and market concentration. However, it is well understood that a wide range of factors have driven a rise in concentration in many industries across the economy. Secondly, the Proposal assumes that the optimal distribution of rebates is a more even distribution of rebates across all exchange members. More practically, it is most efficient to distribute a finite supply of incentives to high-volume market participants as a way to maximize overall welfare for all participants. Lastly, the Proposal incorrectly interprets economic literature to support the Proposal's aim. While it cites consumer theory in support of the potential benefits of the Proposal, it fails to acknowledge that consumer theory also points to costs for consumers when government intervenes without evidence of market failure (for further discussion of each fallacy see Appendix I).

²¹ See Proposal at 76321 and 76325.

8. Cboe's fees undergo extensive legal review and are consistent with the Act.

The Proposal makes various statements regarding the Commission not having enough information in order to properly determine whether or not the pricing proposals submitted by exchanges are consistent with the Act.²² Cboe believes that the Commission's concerns in this regard are not only unfounded, but inconsistent with the stringent exchange rule filing process currently in place, which is specifically designed to ensure SROs provide the Commission and the public with all necessary information needed to evaluate SRO proposals.

First, Section 19(b) of the Act, and its rules thereunder,²³ requires every SRO to file with the Commission any proposed rule change from the rules of the SRO, including fee changes. All proposals must be submitted to the Commission for review on Form 19b-4, which is designed to elicit information necessary for the public to provide meaningful comment on the proposed rule change and for the Commission to determine whether the proposed fee rule change (including any fee change) is consistent with the requirements of the Act and related rules and regulations. The burden to demonstrate consistency with the Act is on the SRO submitting the proposed rule change.²⁴

Secondly, in 2010, Congress created a more efficient process for the review and consideration of certain SRO rule changes, including fee filings as part of the Dodd-Frank Act.²⁵ The relevant portion of Section 19(b)(3)(C) of the Act, as amended by the Dodd-Frank Act, provides in part:

“At any time within the 60-day period beginning on the date of filing of such a proposed rule change in accordance with the provisions of paragraph (1), the Commission summarily may temporarily suspend the change in the rules of the self-regulatory organization made thereby, if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in further of the purposes of the Exchange Act. If the Commission takes such action, the Commission shall institute proceedings under paragraph (2)(B) to determine whether the proposed rule should be approved or disapproved. Commission action pursuant to this subparagraph shall not affect the validity or force of the rule change during the period it was in effect and shall not

²² Id at 76293 and 76299.

²³ See 17 CFR § 240.19b-4 19b-4.

²⁴ See Rules of Practice Governing Disapproval Proceedings for SRO Proposed Rule Change Filings and for Proposed NMS Plans and Plan Amendments § 201.700(b)(3) (“A mere assertion that the proposed rule change is consistent [with the Act and its rules and regulations thereunder]...is not sufficient. Instead, the description of the proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding.”), available at <https://www.sec.gov/about/rulespracdisapprovalproceedings022011.pdf>; see also General Instructions to Form 19b-4 (“The self-regulatory organization must provide all required information presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.”), available at: <https://www.sec.gov/files/form19b-4.pdf>.

²⁵ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 § 916, 124 Stat. 1376, 1833 (2010); see also 17 CFR 240.19b-4.

be reviewable under section 78y of this title nor deemed to be “final agency action” for purposes of [the APA].”²⁶

As part of the Commission’s review of fee filings, it shall determine that the proposed fee or fee change: (i) is an equitable allocation of reasonable dues, fees, and other charges;²⁷ (ii) is “not...designed to permit unfair discrimination between customers, issuers, brokers, or dealers”;²⁸ and (iii) does “not impose any burden on competition not necessary or appropriate in furtherance of the purposes of” the Act.²⁹ Should the Commission decide, during its review of the proposed fee or fee change, that it is unequitable, unfairly discriminatory, or imposes a burden on competition, it is obligated to suspend the proposal, which triggers a requirement for notice-and-comment approval proceedings.³⁰ Furthermore, as soon as practicable after the date of filing a proposed fee or fee change, the Commission is required to publish notice of such filing, which must include the substantive terms of the proposed fee or fee change, allowing for the general public to submit comments.³¹ Accordingly, interested persons are also always afforded the opportunity to submit comments for each proposed fee or fee change.³²

Every exchange volume-based fee, indeed every exchange fee, has been subjected to this process. Further, market participants are aware that transaction fees, such as the volume-based transaction fees at the center of the Proposal, are generally updated monthly by exchanges. Market participants, therefore, are familiar with the 21-day window in which to submit comments on proposed fees. In Cboe’s experience, even though market participants are given the opportunity to submit comments on proposed transaction fees and rebates, there have been very few instances where a comment letter has been received following the notice and publication of a proposed transaction fee.

The Proposal states that increased transparency and disclosures by exchanges are needed because the Commission and public commenters lack sufficient information in exchange filings in order to determine whether proposed tier changes are reasonable, equitably allocated, not unfairly discriminatory, and do not impose a burden on competition that is not necessary or appropriate in furtherance of the Act.³³ However, fee filings provide more robust discussion and quantitative and qualitative data than ever before. There is also nothing preventing the Commission from requesting additional information from the exchanges when proposed fees are filed. In fact, it is not uncommon for SEC staff to request, and Cboe to in-turn provide, additional information with respect to fee filings. The SEC asserting that it does not have sufficient information by which to judge the merits of a proposed transaction fee filing rings hollow.

²⁶ 15 U.S.C. 78s(b)(3)(C).

²⁷ 15 U.S.C. 78f(b)(4).

²⁸ 15 U.S.C. 78f(b)(5).

²⁹ 15 U.S.C. 78f(b)(6).

³⁰ 15 U.S.C. 78s(b)(3)(C).

³¹ Id.

³² 15 U.S.C. 78s(b)(1).

³³ See Proposal at 76293.

In response to viewpoints expressed by certain market participants that Exchange fees, particularly volume-based pricing tiers, discriminate against small aggregate volume customers, it is important to note that Congress intended for the Act to allow for some amount of differentiation. Form 19b-4 itself acknowledges that some differentiation in forms of competition may be necessary and appropriate under the Act.³⁴ Cboe's fee schedule is designed to encourage brokers to submit liquidity to the exchange through various tiers that offer different incentives based on achieving certain criteria that are commensurate with the published incentive. It is important to keep in mind that brokers have different business models (e.g., agency brokers versus market makers/liquidity providers), manage and handle different types of order flow, and have different investment benchmarks. As such, certain tiers and incentives may be appealing or unappealing based on a variety of factors that influence whether or not a broker strives to satisfy the criteria for certain tiers. The fee schedule must be looked at holistically and each tier must be reviewed in the context of the fee schedule as a whole and in the context of each individual broker.

9. Additional requirements are aimed at the wrong market participants.

The Proposal would also require equities exchanges that have volume-based transaction pricing for member proprietary volume to submit electronically to the Commission disclosures of the number of members that qualify for their volume-based transaction pricing.

We do not have strong views on the disclosure portion of the Proposal, but we find it perplexing that the Commission is focused on heightened transparency for exchanges that are already subject to heavy transparency and regulation. As discussed above, all exchange fees and trading rules are filed with the SEC and published in the Federal Register for public comment. An exchange's rules are required to be published and available on its website. There is no similar requirement for other market participants including non-exchange trading venues.

In terms of the proposed requirement for exchanges to implement and maintain anti-evasion measures described in proposed Rule 6b-1(b)(1), which is intended to mitigate the incentive to mischaracterize order capacities, we note the responsibility to properly mark an order as principal or agency lies with the broker submitting the order to the Exchange and is governed by exchanges rules, such as BZX Rule 11.21 – Input of Accurate Information.³⁵ If the expectation is that the exchanges must systematically and/or in real time ensure that brokers are not mislabeling orders in order to prevent a broker from trying to circumvent the prohibition on volume-based transaction pricing for agency-related orders, then that could be a significantly burdensome undertaking not accounted for in the Proposal's estimates.

³⁴ See Section 4, Self-Regulatory Organization's Statement on Burden on Competition, Form 19b-4 ("Explain why any burden on competition is necessary or appropriate in furtherance of the purposes of the Act."), available at: <https://www.sec.gov/files/form19b-4.pdf>.

³⁵ Exchange Rule 11.21, Input of Accurate Information, provides: Members of the Exchange shall input accurate information into the System, including, but not limited to, whether the Member acted in a Principal, Agent, or Riskless Principal capacity for each order entered.

10. The Proposal fails to consider an important reasonable alternative: finalize certain pending equities market structure reform rulemakings and re-assess impact in new environment.

The Commission considered several alternatives to its Proposal including 1) banning volume-based pricing for all orders, 2) banning volume-based pricing for all orders except those of registered market makers, 3) proceeding with transparency provisions for all orders without banning tiers, and 4) banning only the linking of volume-based tiers for closing auctions to consolidated volume, among others related to the disclosures.

We support consideration of a range of possibilities and note that Cboe would not be opposed to the third alternative listed if need be: instituting no bans on volume-based pricing but adding transparency provisions for all orders. The most prudent alternative we favor, however, not listed in the Proposal, is for the Commission to properly evaluate any other equities market structure proposal that is adopted and implemented to better understand its impact as well as the potential impact of this particular Proposal in conjunction with whatever is adopted. For example, if the SEC proposals on best execution or order execution quality disclosures are adopted, it is possible that concerns motivating this Proposal would be null.

We believe the SEC cannot weigh this Proposal in a vacuum. The motivations for many of the rules overlap and the obligations at times conflict with each other. For instance, price interventions of any sort are highly disruptive. And yet, the SEC is proposing to inappropriately compress access fee caps³⁶ in one proposal while imposing burdensome limits on volume-based rebate tiers with another. Each proposal, but especially both taken together, would severely impact exchanges' ability to compete with other trading platforms and also involve the unnecessary imposition of government price controls into well-functioning markets where exchange fees must already be reviewed and allowed by the Commission. These actions are ill-advised and in conflict with our laws, congressional intent, and the SEC's mission. We strongly urge the Commission to carefully factor in the interrelationships between all outstanding proposals and avoid rushing any given proposal to the front of the line without properly weighing all associated costs.

Cboe appreciates the opportunity to shares its views on the Proposal and welcomes the opportunity to discuss these comments further.

Sincerely,

s/Patrick Sexton

Patrick Sexton
EVP, General Counsel & Corporate Secretary

³⁶ Cboe opposes access fee caps and any lowering of existing fee caps. Any government fee setting is ill-advised and unwarranted. See Cboe comment letter Re: Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, File No. S7-30-22; Order Competition Rule, File No. S7-31-22; Regulation Best Execution, File No. S7-32-22; Disclosure of Order Execution Information, File No. S7-29-22, available at: https://cdn.cboe.com/resources/government_relations/Cboe-Response-to-SEC-Market-Structure-Proposals-3-31-23.pdf

Appendix I. Key Concerns with Commission’s Cost-Benefit Analysis

The Commission fails to meet the requirement of conducting an adequate cost-benefit analysis, given the assumptions and data interpretations underpinning the Proposal are flawed in many respects, including:

- 1) The analysis and Proposal do not show any evidence for the causal links it assumes exist or the supposed benefits it aims to deliver. For instance, the Commission provides data purporting to show that rebates – and specifically the maker-taker model – incentivize concentration of order flow to the detriment of exchanges that do not offer rebates. The Commission looks at the market share of exchanges broken down by whether the transaction pricing model they use is maker-taker, inverted, or flat. This data, however, does not prove a causal relationship between tiering and market share, nor does it show that exchanges without maker-taker models are struggling to compete. For instance, in the Commission’s own projected revenue estimates for January 2023, an exchange using a flat fee model brought in \$19.3 million, almost double the \$10.8 million in projected revenue to an exchange operator with much higher market share utilizing tiered rebates.³⁷ We note many other factors drive the patterns observed including but not limited to economies of scale and high fixed costs associated with entry into the trading ecosystem, which the Commission acknowledges exist but minimizes as a consideration throughout the Proposal. An alternative approach could have been to explore all the factors that contribute to concentration instead of working backwards from the pre-determined conclusion that rebates cause concentration.
- 2) The analysis and Proposal largely conflate the concept of “allocative efficiency,” which typically refers to the *optimal* distribution of goods or services in an economy, with even or equal allocation. The Commission posits that the elimination of tiered pricing for customer orders will likely improve “allocative efficiency,” by which it means that it expects exchange members will more evenly distribute order flow on exchanges. This assumes that even allocation of order flow is a more *efficient* allocation. However, in some industries, allocative efficiency does not equate to even or equal allocation, particularly when there are high fixed and regulatory costs associated with doing business. In this context, when trading volume is artificially distributed evenly through government intervention, the result can be a dilution of trading activity across multiple venues that can significantly reduce liquidity within each venue, ultimately harming the overall market quality of the equities market.
- 3) The analysis and Proposal discount or entirely disregard the costs imposed by government intervention widely understood in economics literature. The Commission cites economic consumer theory literature to suggest that volume-based discounts in some instances may reduce consumer surplus. In an efficient market, consumer and producer surplus is maximized. In the context of financial markets, consumer surplus is the analog to investor surplus, or put simply, the difference between what the investor is willing to pay and what they actually pay (the net benefit left in their hands). Notably absent from the

³⁷ See Proposal at 76301.

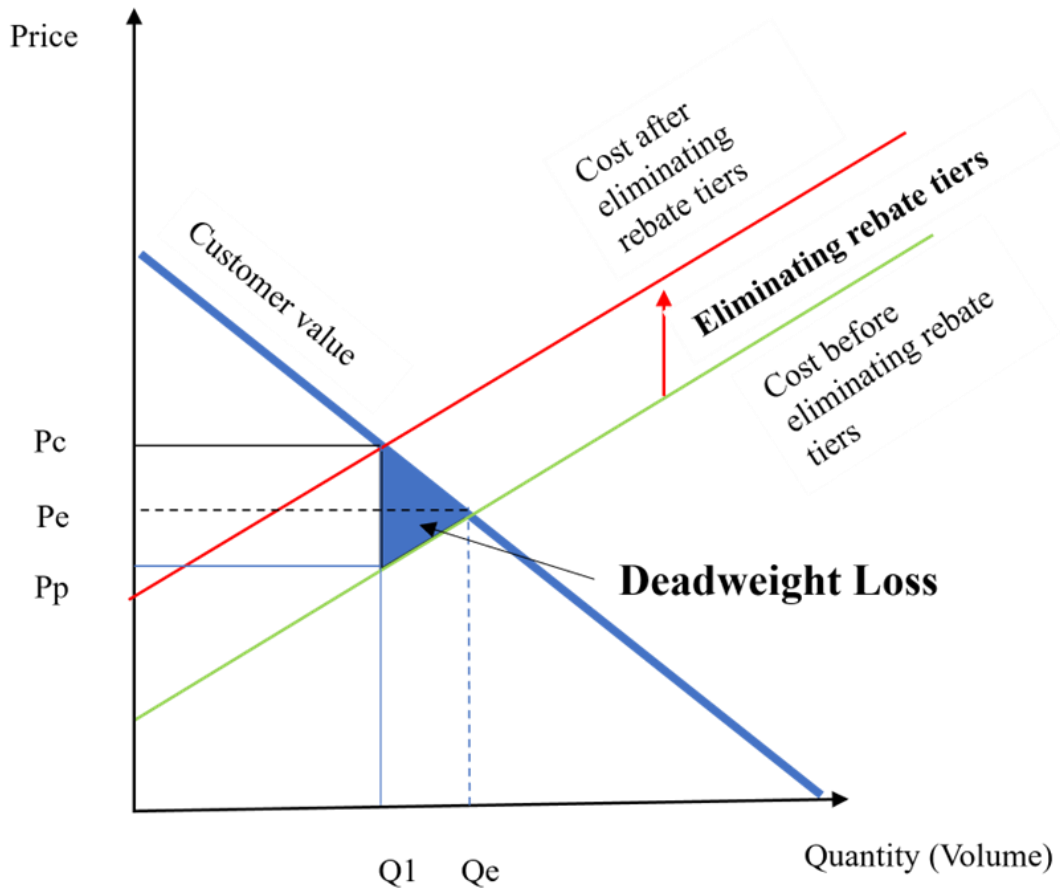
Commission's discussion, however, is the fundamental economic principle that when the government intervenes in markets not experiencing market failure this leads to deadweight loss, and shrinkage of consumer or investor surplus.³⁸ This is because government intervention - in this case by eliminating rebate tiers for customer transactions - distorts the price that consumers pay, and suppliers receive, rather than maximizing their surplus.

- In Figure 1, we depict the consequences of eliminating rebate tiers for customer orders, offering a simplified representation. In this context, the supplier is the broker, and the consumer is the customer of the broker and investor. The elimination of rebate tiers for customer orders will increase transaction costs for customers, which will shift the supply curve upward (from the green to the red line). This is something the Commission acknowledges for some investors though we would argue this will ultimately impact all investors.³⁹
- In turn, the equilibrium price (P_e) and the equilibrium quantity (Q_e) in the absence of government intervention (current environment with rebate tiers for all order flow) will change. Consumer costs will rise to P_c and trading volume will decline to Q_1 . What this means in practice is that eliminating rebate tiers for customer orders negatively impacts both consumers *and suppliers* from deadweight loss, as indicated by the shaded blue triangle.

³⁸ See Clifford Winston, 2006, *Government Failure versus Market Failure: Microeconomics Policy Research and Government Performance*, AEI-Brookings Joint Center for Regulatory Studies.

³⁹ See Proposal at 76319. "In the absence of the ability of exchanges to use volume-based transaction pricing for agency-related flow, investors which rely on high-volume exchange members for market access may be left with relatively more expensive exchange transaction fee options."

Figure 1. Impact of Eliminating Rebate Tiers



Appendix II. Answers to Key Questions

Questions related to prohibition on volume-based exchange transaction pricing for agency-related volume.

1. Do commenters believe that volume-based exchange transaction pricing impacts competition among members when competing for customers on an agency basis? Do sponsored access and direct market access arrangements contribute to these competitive effects when exchange members compete for customers? Why or why not? Does volume-based exchange transaction pricing impact competition among members when trading proprietarily? If there is an impact, is the impact greater for members when they are competing for customers or when they are trading proprietarily, or is the impact equivalent?

Competition among exchange members for customers on an agency basis is driven by many factors besides volume-based exchange pricing. Quality of service, degree of specialization, technology used, customer preferences, and market trends are all important channels through which a member might gain a competitive advantage over other members in connection with the execution of agency or riskless principal orders in NMS stocks.

Eliminating volume-based discounts for customer orders might seem like a targeted way to limit perceived benefits that high-volume members receive vis-a-vis small-volume members. In reality, however, the removal of this tool will negatively impact *all* participants in the ecosystem almost immediately including customers. Without volume-based discounts for agency flow, members benefitting from the higher rebate tiers will immediately see their costs increase, and will be unable to pass down the same level of savings to investors that they were previously able to transfer. We can also infer that smaller-volume members will pay more as they were also being served by the large-volume members. Perhaps even more damagingly, that ban would negatively impact quoted depth and spreads in NMS stocks – a result that directly conflicts with the Commission’s mission.

Please see section 1. *The Proposal is unlikely to help competition between broker-dealers the way the SEC envisions.*

2. Do commenters believe that volume-based exchange transaction pricing exacerbates the conflict of interest between members and customers when members are routing customer orders, because of the member’s desire to qualify for volume-based transaction tiers? Would complete pass through of exchange pricing to the member’s customer eliminate that conflict? Why or why not? To what extent do members completely or partially pass through all exchange pricing to their customer? Do customers prefer pass through exchange transaction pricing or broker commissions, and for what reasons? Is the Commission’s understanding correct that full and partial pass-through of exchange transaction pricing by members to their customers is less common? For sponsored access and direct market access arrangements, how common is pass-through of exchange transaction fees? What types of pass-through arrangements are most common and how much does the sponsoring member typically retain as compensation?

We believe the Commission does not make a strong case in its Proposal about the existence of conflicts of interest between members and customers. In fact, elsewhere in the Proposal the facts presented are contradictory and suggest no conflicts exist. We describe this contradiction in our letter.

Please see section 5. *The Proposal assumes conflicts of interest are rampant with no evidence and contradictory assumptions.*

3. To what extent does volume-based exchange transaction pricing impact competition among exchanges, and/or between exchanges and off-exchange venues, such as alternative trading systems (“ATs”) and wholesaler broker-dealers?

The Proposal would be very damaging to venue competition. For an exchange to compete effectively, it needs to differentiate itself and offer a compelling reason for order flow to be routed there. Rebate tiers are an important mechanism in that regard, as exchanges can use volume-based pricing tiers to compete for order flow with off-exchange market centers. Banning this important competitive tool risks accelerating the shrinking of the addressable market for which exchanges compete today.

Additionally, the Commission suggests that the elimination of volume-based tiers would benefit markets by prohibiting the primary listing exchanges from tying discounted closing auction fees to a member’s intraday trading volume. However, this will not have the intended impact of improving competition between exchanges for a few reasons as we describe in our letter.

Please see section 2. *The Proposal will actually hurt competition between venues by taking away an important competitive tool.*

5. To what extent is the ability of an exchange to attract order flow from specific types of members or customers through volume-based exchange transaction pricing or other forms of targeted pricing necessary to support competition between exchanges and off-exchange venues? For example, if exchanges lack the ability to offer such pricing on agency-related order flow, could that potentially make off-exchange venues relatively more attractive as a destination for that flow? If so, should the Commission address such a competitive disparity? For example, should the Commission expand the scope of the prohibition on volume-based transaction pricing for agency-related volume in certain stocks to off-exchange venues such as ATs?

Banning volume-tiers for agency-related order flow would be inappropriate for both exchanges or off-exchange venues for all the reasons described in this letter including the potential higher costs for investors. We do, however, believe there are opportunities for the SEC to address other competitive disparities between exchanges and non-exchange venues through regulatory harmonization.

8. Would the proposed prohibition on volume-based exchange transaction pricing in connection with the execution of agency or riskless principal orders in NMS stocks address

the concerns the Commission identified about member competition and conflicts of interests between members and customers? Why or why not?

In the Proposal, the Commission mentions several types of perceived conflicts the ban would hypothetically solve but elsewhere in the Proposal the facts presented are contradictory. It is widely understood that *potential* conflicts of interest are commonplace in the financial industry. Conflicts of course need to be managed appropriately, but there is scant evidence that volume-based fees are harming investors or causing brokers to ignore their obligations to investors.

Even if we were to assume that unmanaged conflicts associated with volume-based exchange fees are rampant, Cboe believes it is entirely inappropriate for the SEC to manage *broker* conflicts by restricting *exchanges*. Banning a longstanding exchange practice that enables exchanges to compete for order flow would not address the source of the perceived problem.

Please see section 5. *The Proposal assumes conflicts of interest are rampant with no evidence and contradictory assumptions.*

16. Should the Commission prohibit volume-based exchange transaction pricing for agency-related orders also for listed options? Why or why not? Would extending the prohibition to listed options implicate the same costs and benefits that would apply to a prohibition on volume-based exchange transaction pricing for NMS stocks, or are there unique aspects of the listed options markets that would apply different costs or result in different benefits? What would those differences be?

No, it should not. In options markets, smaller brokers will also send order flow to larger operations as it suits their needs. The relationship between brokers that the Commission appears to think is unhealthy is not going to change because the relationship has much more to do with other factors than rebates.

More important, however, is that the option market is very different than the equities market and porting any reform adopted in the equities market to the option market would be even more calamitous and incredibly reckless. There are so many key structural differences between these markets that would inform different cost-benefit analyses.

17. If the Commission also prohibits volume-based exchange transaction pricing for member proprietary volume in NMS stocks, should listed options also be included within the broader prohibition? If the Commission were to adopt a broader prohibition on all volume-based exchange transaction pricing and apply it to all NMS securities (including NMS stocks and listed options), should it carve-out displayed liquidity-adding orders from an exchange's registered market makers in their assigned options classes and series from such a prohibition? Should there be any particular minimum quantitative and qualitative quoting requirements to qualify for the carve-out? Would such a carve-out for listed options be an appropriate benefit to encourage members to become and remain registered market makers and undertake registered market making obligations in the same way that it would for NMS stocks? Does tiered pricing encourage greater quoted depth or narrower quoted spreads, or both, for listed options in a similar manner to NMS stocks? If the Commission were to allow

exchanges to offer volume-based transaction pricing but require that tiers be aggregated across all members and the associated pricing be applicable to all members uniformly, should that condition apply to listed options as well as NMS stocks?

Absolutely not. We believe the Commission prohibiting volume-based exchange transaction pricing for member proprietary volume in NMS stocks or options would be disastrous for markets, given most liquidity comes from proprietary trading interests. Anything that diminishes liquidity provision is bad for end users, market quality, the economy, and global markets.

While carving out displayed market-maker liquidity-adding orders would be preferable to not allowing it, the Commission would nevertheless be making a colossal mistake in banning anything as it relates to listed options (or equities). Option markets already have quoting standards in place and incentivize minimum quantitative and qualitative quoting requirements. We see this setting of incentives and adjustments as purely an exchange function that we use as needed, and it works well, so there is nothing broken to be fixed. We strongly believe we have struck a good balance between requirements and incentives. To impose new requirements for these types of programs would not only be inappropriate but would also be overly burdensome and harmful, especially during volatile market conditions.

Moreover, it is inconceivable to discuss how this Proposal and these specific questions raised would impact options markets in a handful of paragraphs. Inclusion of throw-away questions related to listed options is inappropriate and risks harming well-functioning markets. We urge the Commission to recognize the inherent differences between options and equities markets.

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

There is not a lack of transparency. As discussed in our letter, unlike most market participants, all exchange fees and trading rules are filed with the SEC and published in the Federal Register for public comment. An exchange's rules are required to be published and available on its website. We do not have strong views on the disclosure portion of the Proposal, but we find it concerning that the Commission is focused on heightened transparency for exchanges that are already subject to heavy transparency and regulation, while not proposing or addressing pricing transparency as it relates to venues which comprise close to half of the market.

Please see section 9. *Additional disclosure requirements are aimed at the wrong market participants.*

32. The Commission discussed above how the presence of volume-based transaction pricing on exchanges introduces a potential conflict of interest, because it gives broker-dealers an incentive to route agency-based volume in a way that minimizes exchange fees for the broker-dealer. Is such a conflict of interest present? The Commission requests comment on the impact of such potential conflicts of interest.

FINRA Rule 5310 requires broker-dealers to meet best execution requirements, and the SEC has proposed its own best execution rule. Given this particular type of conflict of interest is already the singular focus of existing and proposed rules, enforcement of those rules is likely the most effective tool to deal with this perceived conflict of interest.

Please see section 5. *The Proposal assumes conflicts of interest are rampant with no evidence and contradictory assumptions.*

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

Many other factors drive concentration in markets including but not limited to economies of scale and costs associated with entry into the trading ecosystem, which the Commission acknowledges exist but minimizes as a consideration throughout the Proposal.

Please see section 7. *The Proposal's economic analysis is insufficient and flawed and Appendix I. Key Concerns with Commission's Cost-Benefit Analysis.*

50. Do commenters agree with the Commission's assessment of the benefits stemming from the effects of the volume-based prohibition on agency-related order pricing and competition among broker-dealers? In particular, would lower-volume exchange members end up with lower fees and higher rebates under such a ban? Would a flat fee and rebate for agency-related volume increase competition among broker-dealers to provide exchange access? Would investors benefit from the lower prices for lower-volume exchange members and lower barriers to entry in the NMS equity brokerage business?

No, we disagree for all the reasons discussed in this letter.

Please see section 3. *The Proposal will likely increase costs for investors.*

51. Would prohibiting the application of volume-based pricing for agency-related order flow and the proposed disclosure provisions promote or impede competition between exchanges? Does the Commission adequately capture the costs and benefits resulting from the effect of the proposed rule on competition among exchanges?

It would impede competition between exchanges.

Please see section 2. *The Proposal will actually hurt competition between venues by taking away an important competitive tool.*

52. What impact would an elimination of volume-based pricing on agency-related order flow have on the NBBO, including the spread width and depth of displayed interest at the NBBO?

We expect spread width and depth will deteriorate, as discussed in the introduction to this letter.

56. Do commenters agree with the Commission's description of the indirect costs and reduction in efficiency which may result from a reduction of order-flow executed by higher-volume exchange members on exchanges?

Yes, we agree with the costs the Commission briefly (and insufficiently) acknowledges including

- Market shrinkage, fragmentation, and migration to off-exchange venues, decreasing total order flow across exchanges, harming on-exchange liquidity, and increasing trading costs;
- Harm to broker-dealers and exchange members (i.e., increase transaction costs);
- Widening of NBBO spreads and costlier search for best price for the remaining participants (both agency and principal) on the exchange;
- Efficiency loss (i.e., directing more order flow to the lower-volume exchange members might result in resources being inefficiently utilized, as high-volume exchange members might be most efficient at executing trades due technology, capital or service strength arising from their scale economies); and,
- Distortion of the market (i.e., increased dispersion of agency flow and increase the concentration of principal order flow across exchanges)

Please see section 7. *The Proposal's economic analysis is insufficient and flawed* and *Appendix I. Key Concerns with Commission's Cost-Benefit Analysis.*

58. Would the proposed rule affect the ability of exchanges to compete with off-exchange venues? Do commenters agree with the Commission's assessments of the costs from order flow potentially moving to off-exchange venues?

It would harm exchanges' ability to compete with off-exchange venues.

Please see section 2. *The Proposal will actually hurt competition between venues by taking away an important competitive tool.*

59. Are there any additional benefits or costs from the prohibition of volume-based transaction pricing for agency-related volume that you believe the Commission did not discuss?

We believe the SEC cannot weigh this Proposal in a vacuum. The motivations for many of the rules overlap and the obligations at times conflict with each other. For instance, price interventions of any sort are highly disruptive. And yet, the SEC is proposing to inappropriately compress access fee caps in one Proposal while imposing burdensome limits on volume-based rebate tiers with another. Each proposal, but especially both taken together, would severely impact exchanges' ability to compete with other trading platforms and also involve the unnecessary imposition of government price controls into well-functioning markets where exchange fees must already be reviewed and allowed by the Commission. These actions are ill-advised and in conflict with our laws, Congressional intent, and the SEC's mission.

We strongly urge the Commission to carefully factor in the interrelationships between all outstanding proposals and avoid rushing any given proposal to the front of the line without properly weighing all associated costs.

Please see section 10. *The Proposal fails to consider an important reasonable alternative: finalize the equities market structure reform rulemakings and re-assess impact in new environment.*

Additionally, we believe the analysis and Proposal discount or entirely disregard the costs imposed by government intervention widely understood in economics literature. The Commission cites economic consumer theory literature to suggest that volume-based discounts in some instances may reduce consumer surplus. Notably absent from the Commission's discussion, however, is the fundamental economic principle that when the government intervenes in markets not experiencing market failure this leads to deadweight loss, and shrinkage of consumer or investor surplus. This is because government intervention - in this case by eliminating rebate tiers for customer transactions - distorts the price that consumers pay, and suppliers receive, rather than maximizing their surplus.

Please see section 7. *The Proposal's economic analysis is insufficient and flawed and Appendix I. Key Concerns with Commission's Cost-Benefit Analysis.*

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

The Proposal largely conflates the concept of "allocative efficiency," which typically refers to the *optimal* distribution of goods or services in an economy, with even or equal allocation. The Commission posits that the elimination of tiered pricing for customer orders will likely improve "allocative efficiency," by which it means that it expects exchange members will more evenly distribute order flow on exchanges. This assumes that even allocation of order flow is a more *efficient* allocation. However, in some industries, allocative efficiency does not equate to even or equal allocation, particularly when there are high fixed and regulatory costs associated with doing business. In this context, when trading volume is artificially distributed evenly through government intervention, the result can be a dilution of trading activity across multiple venues that can significantly reduce liquidity within each venue, ultimately harming the overall market quality of the equities market.

Please see section 7. *The Proposal's economic analysis is insufficient and flawed and Appendix I. Key Concerns with Commission's Cost-Benefit Analysis.*

The Proposal is also forcing upon the equities markets a narrow and subjective view of "fair" competition. In almost all other marketplaces, there exist "big" and "small" businesses, where "big" businesses attract a significant majority of consumers, and "smaller" businesses often compete through niche offerings, or business models designed to attract a certain segment of the customer base. It is not clear why the Commission is tasking exchanges with the responsibility of ensuring lower volume broker-dealers can compete with higher-volume broker-dealers when attracting investors. The merits of such a position are contrary to healthy competition.

Please see section 1. *The Proposal is unlikely to help competition between broker-dealers the way the SEC envisions.*