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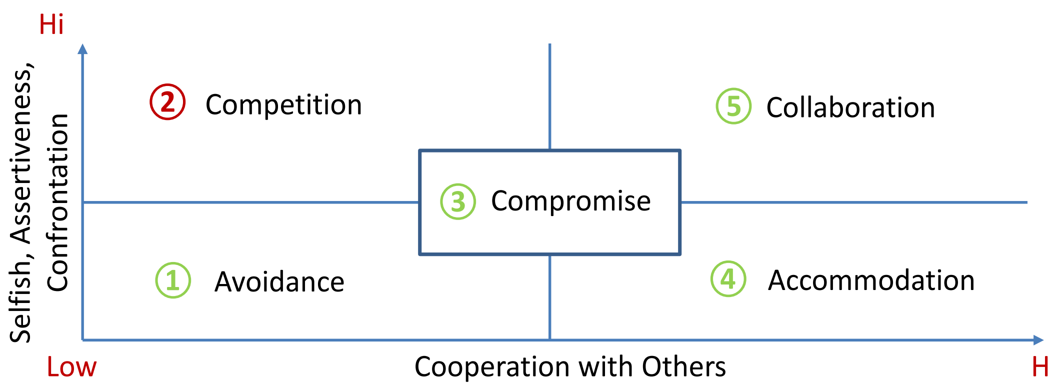
Rebate Tiering and Competitive Pricing of Different Market Centers

The SEC proposal on Volume-Based Exchange Transaction Pricing for NMS Stocks is a well-intended policy come too far behind market developments. We at Data Boiler do support curbing price discrimination practices, although we despise regulatory price control in general. Here, however, our analysis shows the Have-Nots will be hurt more than the Haves. **LACK OF STANDARDS across different market centers' rebate and incentive systems** is at the CORE of all issues.

We do not disagree with Prof. Chester Spatt's research that suggests banning of Exchanges rebate tiering. Yet, there is merit in Mehmet Kinak's comment (T. Rowe Price) at a 2022 SIFMA roundtable, cited, *"Jumping tiers at end of the month* [is one concern]. *Get rid of "tiers" because it removes conflicts of interest that exist, I am all for that.* [Yet,] *it is difficult for institutions to be able to then go ahead and spread whether it is an additional fee or a rebate back to our customers. If that is the reason* [in recalibrating access fees and rebates, it] *ends up pushing potential conflicts upstream, from brokers if they exist currently with their routing to asset managers where now they are having to explain best execution obligations, versus, I am posting to collect a rebate on your behalf versus taking liquidity."*

FREE redistribution of displayed market data for Retail and other freebies, such as zero commission, subsidized investors education programs, etc. are indeed **at the expense of price discrimination practices** that further heighten costs on Proprietary Products (PPs), exacerbating the latency difference, and/or changing rebates/ incentives for others.

Today's market centers are analogous to Private Clubs favoring collaboration. Colocation as a means of allowing a limited number of Haves to also enjoy the privileges (connection speed and faster order input) as the top Elites is a controversy. Even if the Have-Nots are willing to commit their limited resources to compete with the Haves in using collocation, it is not widely available and affordable to most market participants. Research has shown that Exchanges may optimally restrict access to price information by charging a high fee so that only a fraction of speculators buy their Proprietary Products (PPs). In turn, many choose to **collaborate** with the Haves for outsourced execution **rather than compete**.



The Elites have the upper hand over the Have-Nots. They are sponsors of MEMX as well as controlling many affiliated Alternative Trading Systems (ATSs), Systemic Internalizers (SIs), Single-Dealer Platforms (SDPs), and market data vendors. We **doubt the usefulness of anti-evasion measures**. The Haves are working on multicast in private cloud. Yet, multicast is not readily available in public cloud. Related security threats such as unauthorized creation, alternative, destruction, and illegitimate use of data are too dangerous to let multicast run on the public Internet highway.

Without a mass market solution, or so long as the Consolidated Tape (CT) is NOT in competition with PPs, everyone is and will continue be subservient to telecom infrastructure vendors. Therefore, we recommend the policy makers to mandate proper security protection over both SIPs/CC (consolidated tape) and PPs; requiring synchronization of both SIP/CC and PP in accordance with an Atomic Clock and prohibits circumvention of security measures; plus, requiring market centers to maintain a connectivity disparity ratio (< 2.5 to 4 times).

IEX's argument in support of Alternate 1 (banning Volume-Based Pricing for All Orders) per the proposal's footnote 257 is demonizing an otherwise permissible commercial pricing practice for Free Enterprises. The Commission does acknowledge on page 153 of the proposal that *"… principal order flow from proprietary trading … does not have the potential for a conflict of interest between members and customers with respect to routing. Because the member trades for its own account when routing in a principal capacity, only its own interests are at stake in the routing decisions."* Trading in a principal capacity involves risk taking. Risk-return trade-off by tiers is NOT anti-competitive.

Other mentioned alternatives in the SEC proposal are undesirable or minor. Prohibition in proposed Rule 6b-1 for agency and riskless principal orders seems to be a tolerance amid the dilemma. However, **lit Exchanges would lose out even further to off-exchange** (order flow volume, trading cost, fill efficiency) if this proposal is adopted.

Volume tiers to be based on total aggregate volume submitted to the exchange, with the associated tiered pricing applied to all members uniformly is not necessary more equitable as explained in this NASDAQ's article, quoted *"the SIP treats all quotes and trades equally … that's not fair either. In fact, many say the SIPs support fragmentation, rewarding venue competition more than quote competition."* **WHAT GETS PAID** and **WHO GETS WHAT** should NOT be dictated by regulators NOR by a small group of people in a "governance committee". We advocate for a 4-Part test that taken directly from the music industry's copyright laws for objective rate setting.

Access fee rebate, payment for order flow, and market data/ market structure issues are all intertwined. The noumenon of rebate incentives serves as royalty payments for the use of others' copyrighted material. The prevailing market problem is WHO OWNS THE DATA. Policy makers should consider Exchanges, ATSs, SIs, SDPs, and market data vendors as different streaming platforms to have the right focus.

There are many relevant use-cases to learn from the Music Industry (e.g., licensing terms for direct usage, allowing the re-use of contents, and derivative works). According to Prof. Hannes Datta, Prof. George Know, and Prof. Bart J. Bronnenberg in their study, *"adoption of streaming leads to: INCREASES in QUANTITY of consumption … INCREASES in VARIETY of consumption… INCREASE in DISCOVERY of NEW music … Streaming revenue are climbing not only because more consumers are adopting streaming, but because consumers' OVERALL consumption of music is GROWING as well. Streaming creates a MORE LEVEL PLAYING FIELD for SMALLER artists… Streaming EXPANDS consumers' ATTENTION to a WIDER SET of artists… Streaming INCREASES consumer WELFARE by reducing search frictions (e.g., ENHANCING DISCOVERY) and help users DISCOVER NEW HIGH-VALUE CONTENT."* 'Discovery' in the context of Capital Markets, can encompass VERACITY in price discovery, VELOCITY in filling orders/ finding matches, as well as discovering unknowns.

Rebates in the form of standardized copyright royalties across market centers encourage **content creation** and helps **build communities**. CT must be a meaningful mass market alternative to PPs to shake up the dynamics, hierarchy of choices, or 'context effects' (similarity or compromise) per Decision Field Theory. More will commit resources to compete if giving them a fighting chance. 4Vs are essential to contrive a more Equitable New Paradigm and grow the overall pie. There are bigger pieces for everyone, including Exchanges. See our comment letters to the SEC and the FCA for additional thoughts.

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*By **Kelvin To**, Founder and President of Data Boiler Technologies*
At Data Boiler, we see big to continuously boil down the essential improvements that fit for your purpose. Between my patented inventions and the wealth of experience of my partner, Peter Martyn, we are about finding rare but high-impact values in controversial matters, straight talk of control flaws, leading innovation and change, creation of viable paths toward sustainable development and economic growth.