FIA PTG
PRINCIPAL TRADERS GROUP

January 23, 2024

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

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

Dear Ms. Countryman:

The FIA Principal Traders Group ("FIA PTG")[1] appreciates the opportunity to submit this letter to the Securities and Exchange Commission ("SEC" or the "Commission") in response to the above-captioned rule proposal (the "Proposal").[2] As a trade association of principal trading firms ("PTFs") trading their own capital, FIA PTG members are not directly impacted by the Proposal as drafted. We nonetheless oppose the Proposal and ask that it be withdrawn for the reasons detailed below.

Exchange pricing tiers are just one factor among many that govern order routing decisions. FIA PTG does not represent "retail" customers. However, through years of experience, we are familiar with many factors that retail brokers consider when making order routing decisions. First and foremost among those factors is every broker's Best Execution responsibility. Other factors include: real-time quotes (which venues are on the NBBO, etc.); the venue's fee model (maker/taker vs taker/maker, or free, etc.); latency; fill rates; and customer service. The SEC failed to analyze the significance of volume tiers in order routing decisions compared to any of these other factors, which is a material deficiency in the Proposal's analysis.

The Commission's own analysis concludes the Proposal will harm liquidity. Throughout the Commission's economic analysis, it finds that volume-based discounts consolidate liquidity,

[1] FIA PTG is an association of firms, many of whom are broker-dealers, who trade their own capital on exchanges in futures, options and equities markets worldwide. FIA PTG members engage in manual, automated and hybrid methods of trading, and they are active in a wide variety of asset classes, including equities, fixed income, foreign exchange and commodities. FIA PTG member firms serve as a critical source of liquidity, allowing those who use the markets, including individual investors, to manage their risks and invest effectively. The presence of competitive professional traders contributing to price discovery and the provision of liquidity is a hallmark of well-functioning markets. FIA PTG advocates for open access to markets, transparency and data-driven policy.

[2] https://www.sec.gov/files/rules/proposed/2023/34-98766.pdf.

which reduces the cost of searching for best execution. In light of this it is unclear why the SEC issued this Proposal.

The Commission's economic analysis is materially flawed. The economic analysis fails to provide evidence of clear benefits and fails to consider relevant and material metrics. For example, the Commission admits having little information regarding market access arrangements, the extent to which higher-volume firms are passing-through pricing benefits today, or the extent to which factors other than volume tiers are influencing routing decisions. Instead, the Commission relies on academic studies analyzing markets that have little relevance or similarity to equity market structure.

The Commission's proposed use of "Agency" transactions is fatally flawed. A variety of market participants send limit orders to broker-dealers for execution that may be directed to specific exchanges. Therefore, those firms' limit orders are submitted to the market "as Agent" by an exchange member broker-dealer (i.e., a "market access provider"). The proposed rule would inadvertently harm these firms, who are not "retail" customers and are capable of independently navigating the dynamics of volume-based pricing and negotiating fee arrangements with their market access providers.

The Commission should not extend the Proposal to <u>proprietary</u> trading or options transactions. Among the Commission's many proposed alternatives, the Proposal contemplates prohibiting volume tiers for all orders, including for proprietary and options transactions. These alternatives are misguided and would likely cause significant harm for no clear benefits. The most obvious risk from the inclusion of proprietary trading is a reduction in liquidity provision and price discovery, causing harm to the investor and issuer community. Moreover, the Commission acknowledges that the alleged conflicts of interest applicable to "agency" orders are not present for proprietary orders. As a result, this alternative would reduce liquidity and increase transparency for no purported countervailing investor protection benefits. Given the material difference in scope of the rule should the Commission pursue either alternative, the Commission would need to issue a new notice of proposed rulemaking that includes a thorough cost-benefit analysis and affords market participants a meaningful opportunity to comment.

Complex and conflicting interplay of various rules and proposals. Finally, this Proposal is yet another of the myriad overlapping, inconsistent equity market structure proposals currently pending at the SEC. The recent proposal process and timeline has deprived commenters of a meaningful opportunity to comment. Here are a couple of pending examples:

- The SEC's "Tick-Size Proposal"[3] is inconsistent with the Proposal in at least two ways. First, the Tick Size Proposal requires fee tiers to be set in advance. The Commission expressly states in the release that the purpose for this requirement is to increase transparency into volume-based pricing and pass-through fee arrangements. It is unclear why the Commission would simultaneously propose to increase transparency regarding

[3] Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better, 87 Fed. Reg. 80266 (Dec. 29, 2022).

volume-based pricing in one proposal and ban this practice in another. Second, the Tick Size Proposal proposes to reduce the access fee cap, which should be expected to have significant effects on exchange pricing. For example, by reducing the access fee cap, there will be fewer pricing levels below the cap for exchanges to compete over and to tier. Given the potentially significant, and unknown effect on exchange pricing that should be expected if the SEC pursues the Tick Size Proposal, the Commission should not exacerbate uncertainty regarding exchange pricing by considering a second, interrelated proposal on volume tiers.

- Second, the Commission alleges that volume tiers may contribute to a conflict between broker-dealers and their customers. Specifically, the Commission states that "[t]he application of volume-based pricing to non-principal order flow adds to the conflict of interest between a broker and its customer as broker-dealers may be incentivized to execute customer orders in a manner that would not be consistent with the broker-dealer's duty of best execution (to execute customer trades at the most favorable terms reasonably available under the circumstances)."[4] Yet, the Commission did not discuss or analyze this alleged conflict in its proposed Regulation Best Execution.[5] Moreover, the Commissioned failed to examine how this Proposal is intended to intersect with existing best execution requirements.

The failure of the Commission to consider these overlapping and inconsistent regulations alone warrants withdrawal of the Proposal.

In conclusion, exchange volume-based pricing tiers are just one small piece of the much larger transaction pricing picture. Large, high volume market participants may qualify for lower tiered exchange transaction fees while at the same time incurring much higher technology and operational costs than their smaller competitors. Tweaking one piece of the pricing puzzle is unlikely to generate the results the Commission is looking for. Accordingly, FIA PTG reiterates our recommendation that this Proposal be withdrawn.

If you have any questions, please do not hesitate to contact Joanna Mallers at jmallers@fia.org.

Respectfully,

FIA Principal Traders Group

Joanna Mallers

Joanna Mallers
Secretary

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[4] The Proposal at 65.
[5] Regulation Best Execution, 88 Fed. Reg. 5440 (Jan. 27, 2023).

cc: Gary Gensler, Chair
Hester M. Peirce, Commissioner
Caroline A. Crenshaw, Commissioner
Mark T. Uyeda, Commissioner
Jaime Lizárraga, Commissioner