



MODERN MARKETS
INITIATIVE

December 9, 2016

VIA E-MAIL

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C., 20549-1090

Re: Regulatory Flexibility Act (RFA) review of Regulation NMS, File No. [S7-21-16]

Dear Mr. Fields:

Modern Markets Initiative (“MMI”), the industry association dedicated to education and advocacy in support of the benefits of automated trading, appreciates the opportunity to provide written comments in connection with the Regulatory Flexibility Act (RFA) review of Regulation NMS (Reg NMS)¹.

We appreciate the thoughtful approach the Commission has taken with regard to reviewing comprehensive regulations such as Reg NMS, which affect every market participant. Of particular interest to MMI is the mandated RFA consideration of “the length of time since the rule has been evaluated or the degree to which technology, economic conditions, or other factors have changed in the area affected by the rule.”²

In the eleven years since the effective date of August 29, 2005 of Reg NMS³, traders, technologists, physicists, mathematicians and professionals from diverse areas of science and finance⁴ have worked together under the guidance of the Regulation to create market efficiencies, while “transaction costs decreased substantially” for investors.⁵ As these innovations have been introduced, tweaked and then widely adopted, they have “cause(d) prices to be more efficient,”⁶ and “exert(ed) a stabilizing influence on markets”⁷ which has resulted in a market where “margins are very low (and) competition is very high.”⁸ In fact, the world’s largest fund manager estimates investors with a 30-year time horizon now realize 32% more money in their portfolios

¹ Securities and Exchange Commission “List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act” pp. 6-8
<https://www.sec.gov/rules/other/2016/33-10209.pdf>

² Securities and Exchange Commission “Statement Regarding Publication of List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act” <https://www.sec.gov/news/statement/piwowar-statement-list-of-rules-regulatory-flexibility-act.html>

³ Securities and Exchange Commission “Regulation NMS” <https://www.sec.gov/rules/final/34-51808.pdf>

⁴ Nerds on Wall Street: Math, Machines and Wired Markets 1st Edition, by David J. Leinweber

⁵ Paper: The Economics of High-Frequency Trading: Taking Stock by Albert J. Menkveld
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2787542&download=yes

⁶ Securities Exchange Commission DERA Working Papers Series Automated Liquidity Provision <https://www.sec.gov/dera/staff-papers/working-papers/dera-wp-automated-liquidity-provision.pdf>

⁷ Avaniidhar Subrahmanyam and Hui Zheng “Limit Order Placement by High-Frequency Traders”
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2688418

⁸ Committee on Capital Markets Regulation “What is High Frequency Trading?” <http://www.capmktreg.org/wp-content/uploads/2016/10/2014-12-29.CCMR-What-Is-High-Frequency-Trading.pdf>

because of today's modern markets⁹. This technological revolution in the markets has created savings passed on to pension funds, 401k accounts, college savings accounts, university endowments, and others in the savings community.

It has also laid bare some of the deficiencies of Reg NMS. As such, we propose a review of the Regulation in light of technology and efficiencies that have made some measures unnecessary or contributed to market inefficiency. Below, are specific aspects of the Regulation that we believe deserve renewed analysis. Additionally, we continue to advocate a comprehensive review and revision of all of Reg NMS to more accurately reflect today's modern market structure.

The Order Protection Rule

The Order Protection Rule¹⁰ mandates that market participants must incur the costs associated with connecting to any and all registered stock exchanges. When Reg NMS was approved in 2005, the rule protected the best bids and offers of ten registered stock exchanges¹¹. Today, there are 13 registered exchanges¹² and three dormant equities exchanges that Nasdaq owns after its acquisition of ISE¹³. Besides a 30% increase in active exchanges, we believe there are several more that may become active in the near future. In addition, the technical methodologies and costs of connecting to and interacting with exchanges has changed. It is therefore appropriate for the Commission to consider whether it is in need of modification.

Ban on Locked Markets

The prohibition on locking or crossing quotations¹⁴ ignores the fact that there are transaction costs to participants not represented by the publicly displayed NBBO. Thus, using those prices to direct order routing has led to unnecessary complexity and investor confusion. In addition, it has caused exchanges to add myriad order types that have increased market complexity. These and other factors make it appropriate for the Commission to consider whether it is in need of modification.

Competing Consolidators

In Reg NMS, the Commission considered the arguments in favor of and against creating a competing consolidators model for market data. Ultimately, the Commission was "unconvinced that discarding the current model in favor of a multiple consolidator model would benefit investors and the NMS in general."¹⁵ We believe technology has changed in the area affected by the rule such that great benefits could be realized by investors, making it appropriate for the Commission to consider whether Reg NMS is in need of modification.

⁹ Vanguard letter to the Securities and Exchange Commission re: Concept Release on Equity Market Structure File Number S7-02-10 <https://www.sec.gov/comments/s7-02-10/s70210-122.pdf>

¹⁰ Securities and Exchange Commission "Regulation NMS" Section I. Introduction (C)(1) pp. 21-26 <https://www.sec.gov/rules/final/34-51808.pdf>

¹¹ Nasdaq "Reg NMS Frequently Asked Questions" http://www.nasdaqtrader.com/content/marketregulation/regnms/regnms_faqs.pdf

¹² Bats Global Markets https://www.bats.com/us/equities/market_statistics/

¹³ Nasdaq press release "Nasdaq Completes Acquisition of International Securities Exchange" <http://ir.nasdaq.com/releasedetail.cfm?releaseid=977785>

¹⁴ Securities and Exchange Commission "Regulation NMS" Section I. Introduction (C)(1) pp. 26-29 <https://www.sec.gov/rules/final/34-51808.pdf>

¹⁵ Securities and Exchange Commission "Regulation NMS" Section V. Market Data Rules and Plan Amendments (A)(1)(a) p. 242 <https://www.sec.gov/rules/final/34-51808.pdf>

In closing, Modern Markets Initiative stands in broad support of the Commission's efforts to improve what are already the best markets ever for investors. While this letter outlines some specific aspects of the regulation that we believe need immediate reconsideration, we strongly support a holistic, data-driven review of all of Reg NMS. Such a review would provide the best opportunity to enact regulations that encompass the changes in market structure that have occurred since the regulation's introduction and recognize the interdependent nature of today's modern markets.

Thank you for your consideration.

Very truly yours,

A handwritten signature in black ink, appearing to read "W. R. Harts". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

William R. Harts, CEO
Modern Markets Initiative

cc: Mary Jo White, Chairwoman
Kara M. Stein, Commissioner
Michael S. Piwowar, Commissioner
Stephen Luparello, Director, Division of Trading & Markets