



MANAGED FUNDS
ASSOCIATION



February 26, 2016

Via Website Submission

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-23-15; Regulation of NMS Stock ATSS

Dear Mr. Fields:

Managed Funds Association¹ (“MFA”) and the Alternative Investment Management Association² (“AIMA”) (together, the “Associations”) appreciate the opportunity to submit comments to the Securities and Exchange Commission (the “Commission” or “SEC”) on its proposal to amend the regulatory requirements in Regulation ATS under the Securities Exchange Act of 1934 applicable to alternative trading systems (“ATSS”) that transact in National Market System (“NMS”) stocks (the “Reg ATS Proposal”).³ The Associations commend the Commission for this important undertaking in shedding light on dark pools by requiring enhanced public disclosures with respect to the operation of ATSS.

¹ Managed Funds Association (“MFA”) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

² Founded in 1990, the Alternative Investment Management Association (AIMA) represents the global hedge fund industry. Our membership is corporate and comprises over 1,600 firms (with over 10,000 individual contacts) in more than 50 countries. Members include hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. AIMA’s manager members collectively manage more than \$1.5 trillion in assets. See www.aima.org.

³ 80 *Fed. Reg.* 80998 (Dec. 28, 2015) (hereinafter, the “Proposing Release”).

I. Introduction

For several years, MFA has urged the Commission to increase disclosure and transparency to investors about the operations of critical market infrastructure, exchanges and other trading venues. In 2014 and 2015, MFA issued Equity Market Structure Policy Recommendations, which, among other things, recommended that the SEC require an ATS to make publicly available its Form ATS, and provide further information on its operations and order handling procedures.⁴ MFA also recommended that the SEC make available on its website a list of ATSs and links to each venue's Form ATS so investors could better assess the relative merits of various trading venues. In addition, MFA supported FINRA's ATS transparency initiative and recommended that FINRA expand the data it provides to the public to include weekly volume and trade information on a stock-by-stock basis for equity securities traded over-the-counter.

Given these recommendations, the Associations are particularly pleased to see the Commission's Reg ATS Proposal. The proposed framework of enhanced disclosures and SEC review of the new Form ATS-N should greatly assist investors in their understanding of how ATSs operate and address potential conflicts of interest. As discussed in more detail below, the Associations believe the framework should be extended to include ATSs that trade fixed income securities, including government securities. We also provide some suggestions to further refine Form ATS-N, such as the inclusion of quantitative data where appropriate, and other disclosures that are likely to make the form more useful for investors.

II. Scope of Reg ATS Proposal

At its root, the Reg ATS Proposal requires an ATS that transacts in NMS stocks ("NMS Stock ATSs") to provide, for the first time, public disclosures regarding its operations and how it addresses potential conflicts of interest with affiliates and other broker-dealers. The Proposing Release also asks whether the Commission should apply Rule 304 of Regulation ATS to fixed income ATSs;⁵ and as part of its continued cooperation and coordination with other regulators, whether it should include ATSs whose trading activity is solely in government securities.⁶

The Associations believe the Reg ATS Proposal will provide investors with useful information to better assess the trading venues to which they route orders. The Associations also believe the Commission should seek to expand the application of the Reg ATS Proposal to ATSs

⁴ See letter to the honorable Mary Jo White, Chair, SEC, from Stuart J. Kaswell, Executive Vice President & Managing Director, MFA, dated September 28, 2015, and MFA U.S. Equity Market Structure, *A Year in Review and the Push for Continued Vigilance*, September 2015, available at: <https://www.managedfunds.org/wp-content/uploads/2015/09/Equity-Market-Structure-Recommendations-with-Cover-Letter.pdf>. See also letter to the honorable Mary Jo White, Chair, SEC, from Stuart J. Kaswell, Executive Vice President & Managing Director, MFA, dated September 30, 2014, available at: <https://www.managedfunds.org/wp-content/uploads/2014/10/MFA-cover-ltr-eg-mkt-struct-recommendations-final-9-30-14.pdf>, and MFA Equity Market Structure Policy Recommendations, September 30, 2014, available at: <https://www.managedfunds.org/wp-content/uploads/2014/09/MFA-Equity-Mkt-Structure-Recommendations-final-9-30-14.pdf>.

⁵ Proposing Release at 81018.

⁶ *Id.* at 81019.

that trade fixed income securities and government securities. Doing so would greatly enhance transparency and provide important disclosures to market participants, regulators and the public about increasingly important venues of corporate bond trading and cash trading in U.S. government securities.⁷

In today's highly automated trading environment, regulators have recognized the need for more data about markets in fixed income and U.S. government securities, and that public transparency is critical to investor confidence and liquidity.⁸ With scant public disclosures, ATSS have become critical venues for trading in benchmark securities in fixed income markets.⁹ The Associations believe that the potential for technology to achieve more widespread benefits for investors is not being realized, in part, because of the dearth of public disclosures about trading practices and venues. In 2014, Chair White raised similar concerns and noted that SEC staff was focusing on a regulatory initiative to require the public dissemination of the best prices generated by ATSS and other electronic dealer networks.¹⁰ Last year, the staffs of the SEC and other U.S. financial regulators stated that they are committed to enhancing public reporting on U.S. Treasury market venue policies and services.¹¹ The Reg ATS Proposal is the most suitable vehicle for regulators to make progress this year on these important initiatives.

The Associations believe that many aspects of Form ATS-N, if required of ATSS transacting in fixed income or government securities, could greatly enhance public transparency of these markets. Currently, investors and the public alike have relatively little information about ATSS that transact in fixed income or government securities. Many of the concerns surrounding potential conflicts of interest that arise between an ATS and the activities of its bank/broker-dealer operator and affiliates, and the transparency of an ATS's operations, are equally relevant with respect to ATSS that transact in fixed income or Treasury securities, as with NMS Stock ATSS.

Our members have found a significant difference in the level of transparency they receive with respect to non-NMS Stock ATSS, regardless of whether the ATS is under common ownership

⁷ See, e.g., Joint Staff Report: The U.S. Treasury Market on October 15, 2014, (July 13, 2015) (hereinafter referred to as the "U.S. Treasury Market Report") available at: https://www.treasury.gov/press-center/press-releases/Documents/Joint_Staff_Report_Treasury_10-15-2015.pdf. We note that the U.S. Treasury Market Report calls for further study of the U.S. Treasury market and assessment of data available to the public and to sectors of Treasury.

⁸ *Id.* at 47. See also Notice Seeking Public Comment on the Evolution of the Treasury Market Structure, 81 *Fed. Reg.* 3928 (Jan. 22, 2016) at 3931, (hereinafter, "RFI on Treasury Market Structure") available at: <https://www.treasury.gov/press-center/press-releases/Documents/Market%20Structure%20RFI%20Final.pdf>.

⁹ As the Commission and the Department of Treasury have explained, dealer and customer trading in U.S. Treasury securities occur mainly on ATSS. See Proposing Release at n. 237, and Treasury Market Structure at 3928.

¹⁰ Speech by Mary Jo White, Chair, SEC, on "Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors," June 20, 2014, (hereinafter, "Chair White Speech") available at: <https://www.sec.gov/News/Speech/Detail/Speech/1370542122012>.

¹¹ See U.S. Treasury Market Report at 47-48, providing "The staffs of the Treasury, Board, FRBNY, CFTC, and SEC are committed to continuing to appropriately enhance the information made public about the U.S. Treasury market. The authors of the report: . . . Support efforts to enhance public reporting on U.S. Treasury market venue policies and services.

with an NMS Stock ATS or a national securities exchange. Our members believe that at a minimum a trading venue should clearly disclose the manner of its operations, such as the items covered under Parts III and IV of the Commission's proposed Form ATS-N.¹² Our members have found that, at times, it can be difficult to find public documentation about basic processes, such as for example, the procedures or thresholds used to cancel erroneous trades on a non-NMS Stock ATS.

Accordingly, the Associations recommend that the Commission, in coordination with other regulators, expand the scope of the Reg ATS Proposal to cover ATSs that trade fixed income or government securities.

III. Form ATS-N Filing & Review

The Reg ATS Proposal establishes a filing and review process for the new Form ATS-N, which would allow a legacy ATS to continue operating during the review process and require a new ATS to commence operation only after the SEC has deemed the form "effective."¹³ The Reg ATS Proposal also requires NMS Stock ATSs to file material amendments to Form ATS-N with the Commission 30 calendar days prior to the implementation of a material change to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that are subject to disclosure on Form ATS-N.¹⁴

The Associations support the initial filing and review process established by the Reg ATS Proposal. We believe it would be helpful to have the SEC review initial filings of Form ATS-N for completeness and accuracy; legal and regulatory compliance; as well as to help standardize the level of disclosure across ATSs. For example, from our members' experiences with swap execution facilities ("SEF"), we believe it would have been helpful had regulators reviewed SEF rulebook provisions for legal and regulatory compliance prior to the effectiveness of these trading facilities. Our members found certain SEF rulebooks to be inconsistent with legal requirements and, at times, even included provisions that infringed upon regulatory protections for investors.¹⁵ The Associations also support the Reg ATS Proposal requirement that an NMS Stock ATS file a material amendment to Form ATS-N 30 days in advance of implementation of a material change to the operations of the NMS Stock ATS, the activities of the broker-dealer operator or its affiliates.

¹² Proposing Release at 81138.

¹³ *Id.* at 81024.

¹⁴ *Id.* at 81027.

¹⁵ See letter to the honorable Mark P. Wetjen, Acting Chairman, Commodity Futures Trading Commission, from Stuart J. Kaswell, Executive Vice President & Managing Director, MFA, dated January 8, 2014, regarding a "Request for Action by CFTC to Conduct Pre-MAT Compliance Reviews of SEF Onboarding Documentation and to Enforce SEF Rules and Related Guidance," available at: <https://www.managedfunds.org/wp-content/uploads/2014/01/SEF-Rulebook-Issues-Final-MFA-Letter.pdf>.

IV. Proposed Form ATS-N

Form ATS-N requests for: (1) copies of certain materials provided to subscribers and schedules A and B of Form BD; (2) disclosure relating to the activities of the broker-dealer operator and its affiliates in connection with the NMS Stock ATS; and (3) disclosure relating to the manner of operations of the NMS Stock ATS.¹⁶ The Associations are generally very pleased with Form ATS-N and believe that the information will improve investors' ability to evaluate whether to do business with an ATS, and make more informed decisions about where to route their orders. Given the length and comprehensive nature of Form ATS-N, the Associations support the Commission's proposed requirement for an NMS Stock ATS to attach a redline of changes in Part III and/or Part IV when amending Form ATS-N.¹⁷ We believe it would be helpful if in addition to qualitative responses, the Form ATS-N requested an ATS to provide quantitative responses, where applicable, and in particular in certain items of Parts III and IV as discussed below in more detail.

We strongly support the requirement under Item 5 of Part III for an NMS Stock ATS to disclose trading activities on the ATS of its broker-dealer operator and any affiliates. We believe this disclosure will help investors better understand the relationship between an NMS Stock ATS, its broker-dealer operator and any affiliates. We believe it would be even more helpful if Item 5 of Part III additionally requested that an NMS Stock ATS provide a quantitative response, such as the percent of orders or other trading interest by a broker-dealer operator and any affiliates. Similarly, the Associations believe that it would be more meaningful if Form ATS-N added a quantitative component to Item 5 of Part IV, which requests for information regarding segmentation of order flow and notice about segmentation. In describing the segmented categories, we believe an ATS should include a quantitative component to the response, such as the percentage of orders and trades per segment class. A quantitative component for at least these two items would provide investors with more meaningful information regarding the extent to which a broker-dealer operator or affiliate transacts on the NMS Stock ATS.

With respect to Item 16 of Part IV, we appreciate the Commission's efforts to enhance transparency around market quality statistics that an NMS Stock ATS provides to subscribers. In keeping with the spirit of Form ATS-N to empower investors through greater disclosure, however, we believe Item 16 should request for disclosure of market quality statistics where the NMS Stock ATS publishes or otherwise provides to a substantial portion of its subscribers (*e.g.*, 10% or more) aggregate platform-wide order flow and execution statistics that are not otherwise required disclosures under 17 CFR § 242.605. We believe that Item 16 should not require the disclosure of bespoke statistics for a subscriber. From time-to-time, an investor/subscriber may have follow-up questions to an NMS Stock ATS's market quality statistics. We are concerned that if an NMS Stock ATS has to amend its Form ATS-N each time it receives a request for additional information then it will not provide investors with additional information. We suggest revising Item 16 in a way that would not discourage an NMS Stock ATS from providing additional market quality information to investors.

¹⁶ Proposing Release at 81034-81060.

¹⁷ *Id.* at n. 352.

Accordingly, the Associations recommend that the Commission amend Form ATS-N by including quantitative components to Form ATS-N where applicable, including Item 5 for both Parts III and IV; and revising Item 16 of Part IV to require an NMS Stock ATS provide additional disclosures if it publishes or otherwise provides to a substantial portion of its subscribers aggregate platform-wide order flow and execution statistics of the NMS Stock ATS that are not otherwise required disclosures under 17 CFR § 242.605.

V. Protection of Confidential Trading Information

The Reg ATS Proposal amends Rule 301(b)(10) of Regulation ATS to require every ATS to have written safeguards and written procedures to protect subscribers' confidential trading information.¹⁸ Item 10 of Part III of Form ATS-N requires an NMS Stock ATS to describe the written safeguards and written procedures to protect the confidential trading information of subscribers to the NMS Stock ATS. The Associations strongly support amending Rule 301(b)(10) to require an ATS to have written safeguards and written procedures to protect confidential trading information. With respect to Item 10 of Part III, we believe it is sufficient for an NMS Stock ATS to describe its written safeguards and written procedures, without including the positions or titles of persons that have access to confidential trading information. We are concerned that requiring disclosure of the positions or titles of persons with access to confidential information would paint a target on such persons and could increase their security risks and risks of receiving phishing attacks.

Accordingly, the Associations recommend that the Commission delete the requirement under Item 10 of Part III of Form ATS-N for an ATS to disclose the positions or titles of persons with access to confidential information.

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¹⁸ *Id.* at 81086.

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The Associations appreciate the opportunity to provide comments and recommendations on the Reg ATS Proposal. We would welcome the opportunity to discuss our views on the Reg ATS Proposal with the Commission or its staff in greater detail. If the staff has any questions, please do not hesitate to contact Jennifer Han at [REDACTED].

Respectfully submitted,

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