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Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Email: rule-comments@sec.gov

Re: Regulation of NMS Stock Alternative Trading Systems; File No. S7-23-15

Ladies and Gentlemen,

Liquidnet, Inc. (Liquidnet) appreciates the opportunity to comment on the Securities and Exchange Commission's rule proposal on the "Regulation of NMS Stock Alternative Trading Systems".¹ Liquidnet is the operator of the Liquidnet Negotiation, Liquidnet H2O and Liquidnet Fixed Income alternative trading systems (ATSs).

Liquidnet supports the objective of the Securities and Exchange Commission (the Commission) to enhance transparency of alternative trading system (ATS) activities. Institutional investors have many choices today as to how to execute their customer orders. At the same time, the market structure is complex. For institutions to achieve best execution of their orders, they must have transparency into how the various markets operate and how their orders are handled. Accordingly, Liquidnet supports the Commission's efforts to enhance the transparency of ATS operations. While we agree with the Commission's overall approach, we have concerns about certain aspects of the proposal, as described in this comment letter.

Liquidnet supports the Commission's emphasis on enhancing disclosure, as opposed to restricting the types of functionality offered by ATSs. As described below, Liquidnet provides significant cost savings to long-term investors. It is important that regulations do not impede the ability of ATSs like Liquidnet to offer services to our customers that reduce their trading costs.

Background on Liquidnet

Liquidnet provides trading services to institutional investors worldwide to reduce their trading costs when executing large block orders. Liquidnet and our global affiliates operate in 43 countries on 5 continents.

¹ Securities and Exchange Commission, "Regulation of NMS Stock Alternative Trading Systems – Proposed Rule", Release No. 34-76464, File No. S7-23-15, December 28, 2015, <http://www.sec.gov/rules/proposed/2013/34-69606.pdf> (accessed February 25, 2016) (the "rule proposal").

A primary component of our trading services is our negotiation system, which enables institutions to negotiate block trades directly with other system participants. Institutions that use Liquidnet reduce their trading costs by avoiding the market impact costs that result when institutional block orders are exposed to high-frequency traders and other short-term traders in the market. Cost savings achieved by institutional investors using Liquidnet are passed on to the hundreds of millions of individual investors globally on whose behalf our clients trade, resulting in reduced trading costs and higher investment returns for these individual investors.

Analysis by Intelligent Financial Systems Limited (IFSL), a UK-based firm that specializes in execution cost analysis for European equities, demonstrates the value of Liquidnet for long-term investors. In its report for January 2016, IFSL computes that Liquidnet provided 98.82 basis points of savings on average relative to execution on an exchange market.² The report further shows that Liquidnet Europe's average execution size for January 2016 was €889,731, resulting in Liquidnet saving each side (the buyer and the seller) €8,792, or the equivalent of \$9,697, on average, for each trade executed on Liquidnet.³ These cost savings are passed on directly to individual long-term investors who are beneficiaries of the accounts managed by our institutional clients.

Because Liquidnet is not an attributed market in the U.S., similar data for the U.S. is not available, but we can estimate the same level of cost savings because we provide equivalent functionality in the U.S. and Europe.

In addition to reduced market impact, Liquidnet provides significant price improvement. In the U.S., the Liquidnet Negotiation ATS provided price improvement of 93.67% during December 2015 (the most recent month for which data is available), relative to the industry average of 15.06% over the same period.⁴ This means that during December 2015 the Liquidnet Negotiation ATS provided a level of price improvement that was more than six times greater than the industry average.

During calendar year 2015, the average execution size on the Liquidnet Negotiation ATS was 40,089 shares, which was 166 times larger than the average execution size on the NYSE Group exchanges (241 shares)⁵ and 212 times larger than the average execution size on NASDAQ (189

² Intelligent Financial Systems Limited (IFSL), "LiquidMetrix Guide to European Dark Pools," <http://www.ifsl.com/LiquidMetrix/DarkPoolGuides>, January 2016 (accessed February 25, 2016).

³ Based on a conversion rate of USD/EUR = 1.1030, as of February 23, 2016, <http://www.bloomberg.com/markets/currencies/currency-converter/> (accessed February 23, 2016). IFSL ranks Liquidnet 1st for cost savings. The second-ranked system is the SLS, a system operated by Liquidnet for the SIX Swiss Exchange.

⁴ Rule 605 data compiled by RegOne Solutions, a division of Markit Ltd., <http://regonesolutions.com/regone/web/me.get?web.home> (accessed February 25, 2016). Subscription required. Data is for December 2015.

⁵ Data compiled from http://www.nyxdata.com/nyxdata/asp/factbook/viewer_edition.asp?mode=table&key=3133&category=3 (accessed February 25, 2016).

shares) during the same period.⁶ For calendar year 2015, the average execution size of the Liquidnet Negotiation ATS also was between 175 and 255 times larger than the average execution sizes of the three largest ATSs by volume.⁷

Fixed income ATSs

Liquidnet supports applying the rule proposal to US equities only at this time. Any review of transparency relating to fixed income trading should take into account the dealer market, as well, which represents the majority of fixed income trading. A primary objective for Liquidnet in operating the Liquidnet Fixed Income ATS is to enhance pricing transparency in the fixed income markets as we make available through our system reference price data from Interactive Data Corporation, Markit and other third-party providers.

US government securities

We do not object to the requirements of Regulation ATS applying to systems that cross trades in US government securities.

Application of rule proposal to non-NMS stocks

The rule proposal requires an ATS to file reports on Form ATS-N with respect to NMS stocks but would apparently require that an ATS continue to file reports on Form ATS with respect to non-NMS stocks.⁸ This could be unduly burdensome. An ATS should have the option to file reports on Form ATS-N for all US equities that it trades, whether listed or unlisted. Otherwise, an ATS operator would have the burden of maintaining two separate ATS filings for what is essentially the same functionality.

Process for approving Form ATS-N filings

Liquidnet does not object to the proposed 120-day period for the Commission to declare a Form ATS-N effective or ineffective. The Commission, however, should not require an ATS to make its Form ATS-N public until the last day of the 120-day period or such other date as the Commission approves all the initial Form ATS-N filings, so that an ATS is not disadvantaged by having to make its Form ATS-N public prior to other ATSs.

⁶ Data compiled from <http://www.nasdaqtrader.com/Trader.aspx?id=MonthlyMarketSummary> (accessed February 25, 2016).

⁷ Data compiled from <https://ats.finra.org/> (accessed February 25, 2016). The three leading ATSs for 2015 were Crossfinder (average execution size of 182 shares), UBS Pin (average execution size of 157 shares), and IEX (average execution size of 229 shares).

⁸ Rule proposal, at p. 107-108.

The Commission should make allowance for ATS changes that are introduced during the 120-day review period such that ATSs are not impeded in their ability to introduce new functionality or make other changes during the 120-day review period.

Advance notice period for material changes

Liquidnet supports retaining the current advance notice period of twenty (20) days for material changes. Increasing the notice period would create an unnecessary delay for ATSs in introducing new functionality and improving existing functionality and processes while providing limited benefit for the Commission.

The Commission has the ability at any time to object to any ATS functionality or to require an ATS to further clarify any aspect of an ATS filing, whether or not the prior notice period has expired. An ATS, prior to introducing a change in functionality, has the responsibility to evaluate whether the proposed change is compliant with Regulation ATS and other applicable regulations. Under the current Regulation ATS, an ATS has the risk that the Commission can object to ATS functionality at any time, whether before or after new functionality has been introduced. This risk will continue to exist. Accordingly, increasing the advance notice period provides minimal benefit for the Commission while impeding ATSs in their ability to introduce enhanced functionality for participants.

We support the Commission's primary objective in this rule proposal, which is to enhance ATS transparency. This objective can be achieved without imposing undue delays on ATSs in introducing new functionality.

Materiality

We appreciate the Commission providing additional guidance as to the types of changes that would constitute material changes under Regulation ATS. The Commission provides that a change "... would be material if there is a substantial likelihood that a reasonable market participant would consider the change important when evaluating the NMS Stock ATS as a potential trading venue".⁹ We agree with this standard because it focuses on the potential impact to the customer.

The Commission identifies eight "scenarios that are particularly likely to implicate a material change"¹⁰ For example, the Commission provides that "a change to [an ATS's] order interaction and priority procedures" or "a change to the manner in which the NMS Stock ATS displays orders or quotes" are scenarios that are particularly likely to implicate a material change. In our view, whether the scenarios that the Commission enumerates would involve a material change would depend on the specific facts and circumstances. As an example, if an ATS were to change the font size in which orders are displayed, we would not consider that to

⁹ Rule proposal, at p. 126.

¹⁰ Rule proposal, at p. 127.

be a material change even though that would literally be a “change to the manner in which the NMS Stock ATS displays orders or quotes.”¹¹

We are particularly concerned about a situation where we introduce new functionality and then need to modify that functionality based on feedback from customers or unanticipated workflows or scenarios. For example, we expect to introduce targeted Invitation functionality in the US during March 2016. We have submitted various filings to the Commission relating to this proposed functionality, commencing in 2015. After significant new functionality like this is introduced, modifications are often required based on customer feedback or unanticipated workflows. In some cases, changes are required for risk management purposes. In this scenario, where the key elements of the proposed functionality have been filed with the Commission more than 20 days in advance (or more than 30 days in advance, as proposed by the Commission), it would be beneficial for an ATS to have the flexibility to make modifications based on customer feedback or to address unanticipated workflows without delay, as long as those modifications are disclosed in advance to customers, would not adversely impact customers, and do not change the key elements of the new functionality that has been introduced and previously described in an ATS filing.

While the eight scenarios identified by the Commission are helpful as examples of scenarios that could constitute a material change, many of them are broadly written. Ultimately, each case should be evaluated based on the general standard set forth in the rule proposal of whether “there is a substantial likelihood that a reasonable market participant would consider the change important when evaluating the NMS Stock ATS as a potential trading venue”.¹²

Requirement for prior Commission approval

We do not object to the Commission having the right to declare a Form ATS-N amendment ineffective during the 30-day advance filing period, though we would hope that the Commission would seek to identify any concerns as soon as practical during the 30-day period such that the ATS could promptly address any issues.¹³

The Commission asks in Question 84 whether it “should affirmatively declare material amendments to Form ATS-N effective.”¹⁴ For the following reasons, we support the Commission’s decision in the rule proposal not to impose this requirement:

- ***Impediment to introduce new trading functionality.*** As noted above, we currently trade in 43 markets globally. Canada is the one country that requires prior regulatory approval of material changes. In many cases, we have been able to introduce functionality in 42

¹¹ Rule proposal, at p. 127.

¹² Rule proposal, at p. 126.

¹³ As discussed above, we have proposed that the Commission retain the current 20-day advance notice period.

¹⁴ Rule proposal, at p. 136.

markets, but we have had to wait several months before we can introduce the same functionality in Canada. This is to the detriment of long-term investors in Canada.

- ***Burden on Commission staff; inefficient allocation of Commission resources.*** The requirement for prior approval imposes an unnecessary burden on Commission staff and takes away needed flexibility to focus on the specific filings and other projects that the Commission staff consider most important.
- ***Minimal to no benefit for the Commission.*** As discussed above, since the Commission can object at any time to functionality that an ATS introduces, whether prior to or after the introduction of the functionality, the benefits of requiring prior approval are minimal.
- ***Reduced communication to Commission staff.*** Liquidnet generally seeks to file in advance as often as possible, whether or not the changes would be deemed material. We do this for two reasons. First, the determination of materiality is subjective, so it is prudent for an ATS to err on the conservative side. Second, Liquidnet is committed to full and open communication with the Commission staff relating to our activities. The result is that Commission staff are better informed regarding our activities. A requirement for pre-approval of any changes that an ATS submits in advance would discourage the ATS from filing changes in advance, with the result that Commission staff would be less informed regarding the ATS's activities and have less opportunity to provide feedback.

We support the approach proposed by the Commission on this issue as it would achieve the same result for the Commission without imposing an unnecessary bureaucratic structure that would be harmful to the Commission, ATSs and long-term investors.

Time period for making filings public

While we support the Commission's rule proposal to enhance ATS transparency, we do not support making all communications between an ATS and the Commission public upon filing, as this would impair open communication between an ATS and the Commission staff. For a material change, we would support making the filing public upon the effective date for the change as specified by the ATS in its filing (or, alternatively, 20 days prior to the specified effective date).

Using a real-world example, we plan to introduce targeted invitation functionality for our equity ATSs during March 2016. We initially submitted a filing relating to this functionality on September 24, 2015 and have submitted amended filings subsequent to that time. If the proposed rule were in effect, we would not have submitted our filing at this earlier date because it would have meant publicly disclosing new functionality months in advance of the live date. This is an example of how a requirement to make all communications public upon filing would impede open communication between an ATS and Commission staff. As an alternative,

we would propose that an ATS filing relating to a specific change be made public upon the effective date for the change. As a second alternative, we would propose that an ATS filing for a specific change not be made public until 20 days prior to the effective date for the change. This would ensure that an ATS is not disincentivized from communicating with Commission staff regarding proposed functionality at an earlier date.

More generally, the Commission should allow for non-public communications relating to a proposed material change. In some cases, an ATS will want to seek input from the Commission on a proposed filing prior to submitting the formal public filing. This type of informal communication process would enhance the level of communication between ATS and Commission staff and improve the overall quality of ATS filings, to the benefit of market participants.

Filing of amendments

We support the requirement for prompt filing of amendments to correct information that was inaccurate or incomplete when filed. The Commission asks whether this aspect of the rule proposal “creates an unreasonable risk to market participants that an NMS Stock ATS might fail to provide accurate, current, and complete information on Form ATS-N when filing the form?”¹⁵ To the contrary, the ability to amend and update filings on an ongoing basis is essential to ensure full and accurate disclosure.

Disclosure is an iterative process. One can look at any Commission, FINRA or exchange rule and find ambiguities in how the rule would apply in particular scenarios. The same would apply for ATS rules. Over time, as new scenarios or use cases arise, an ATS must have the ability to update its filing to incorporate those scenarios or use cases. Similarly, if an ATS determines that it can make its disclosure clearer, add detail, or improve the organization of the disclosure, the ATS should be encouraged to do so.

Declaring a Form ATS-N ineffective

We do not object to the Commission having the ability to declare a Form ATS-N ineffective. For the reasons explained above, we support the Commission’s decision in the rule proposal not to require affirmative approval by the Commission for Form ATS-N amendments.

Suspension, limitation or revocation

Under proposed Rule 304(a)(4), the Commission would have the authority, after notice and an opportunity for a hearing, to suspend, limit or revoke an ATS’s exemption from the definition of “exchange”, which would effectively suspend, limit or revoke the ATS’s right to operate.¹⁶ We are concerned that this process could result in a sanction (such as suspension or revocation of

¹⁵ Rule proposal, at p. 133.

¹⁶ Rule proposal, at pp. 141-150.

an ATS's right to operate) that is disproportionate to an alleged violation. The Commission should reconsider this aspect of the rule proposal.

Public disclosure of Form ATS-N and related Commission orders

As discussed above, we would propose making a filed Form ATS-N amendment public either on the stated date of effectiveness of the functionality described in the Form ATS-N amendment or, alternatively, on the 20th day prior to the stated date of effectiveness.

Also, as discussed above, we would propose making the initial Form ATS-N's for the various ATSs public on the same date to avoid competitive unfairness.

Materials provided to subscribers

Part II of proposed Form ATS-N would require ATS's to attach "a copy of any materials currently provided to subscribers or other persons, related to the operations of the NMS Stock ATS or the disclosures on Form ATS-N."¹⁷ We have two concerns relating to this proposal.

First, we are concerned about the broad scope of this requirement. This could be read to require the filing of any email or IM communication by an ATS employee to a customer. An email could be considered a "material" provided to a subscriber and related to the operation of the ATS. In many cases, the email would relate to a specific order or trade, and disclosure of the email would compromise the customer's anonymity and confidentiality. If an email is not considered a material, how would an ATS distinguish between what is or is not a material? As an alternative, we would propose that an ATS only be required to file specific categories of documents that are made available to users, such as those referenced by the Commission in Question 146 (FIX protocol procedures, rules of engagement, user manuals, frequently asked questions and marketing materials).¹⁸ An ATS also could be required to file an exhibit where necessary to accurately respond to a question on Form ATS-N.

Second, we are concerned about the requirement to make exhibits public. We have documents that we make available to our customers that describe the interfaces that we have developed with specific order management system (OMS) vendors to enable customers of the OMS vendor to interact with our system. These documents may contain confidential information relating to the OMS vendor; consequently, we only provide them to customers of the OMS vendor that are subject to obligations of confidentiality. We similarly may provide documentation to our customers relating to other vendors that may contain confidential information relating to the vendor. We also make available to customers documentation relating to how to connect with our system. These documents may contain port numbers and other information that we restrict for security purposes. As an alternative to the Commission's proposal, we would propose that exhibits be made public only where required to accurately

¹⁷ Rule proposal, at pp. 174-175.

¹⁸ Rule proposal, at pp. 178-179.

respond to the questions on the Form ATS-N. In other words, if the text of an ATS's Form ATS-N fully responds to all the questions on the Form ATS-N, the ATS should not be required to publicly file any exhibits.

While we do not support a requirement for public filing of exhibits (except in the specific case that we identify above), we do support a requirement that exhibits be filed with the Commission. More generally, an ATS should have the ability to file supplemental materials with the Commission that are not part of the public filing as long as the ATS's public filing accurately responds to all questions on the Form ATS-N.

Information regarding smart order routers and algorithms

In Question 219, the Commission asks whether there is information regarding the smart order router or algorithms of a broker-dealer operator or its affiliates that should not be subject to disclosure.¹⁹ We support the requirement for disclosure of how a smart order router or algorithm interacts with any ATS operated by the broker-dealer operator or an affiliate, but it is not necessary to require disclosure of how the smart order router or algorithm interacts with ATSs operated by third-party operators. Requiring that type of disclosure would impose a disclosure obligation on ATS operators that is not imposed on competing broker-dealers that do not operate an ATS.

Shared employees

The Commission should clarify that shared employees need only be disclosed by title and not by name.

Fair access threshold

The Commission asks in Question 246 whether it should propose amendments to Rule 301(b)(5) to lower the trading volume threshold in Regulation ATS that triggers the fair access requirement.²⁰ For the reasons discussed in this section, rather than lowering the trading volume threshold in Regulation ATS, the Commission should exclude block executions from counting towards the fair access threshold.

We have two concerns regarding the fair access requirement: first, the fair access requirement is not well-defined; second, if the Commission were to take an overly strict reading of the fair access obligation, it would adversely impact the ability of ATSs to provide value-added functionality to long-term investors.²¹

¹⁹ Rule proposal, at p. 232.

²⁰ Rule proposal, at p. 247.

²¹ As discussed above, Liquidnet provides customers price improvement that is more than six times greater than the industry average. Further, an independent third-party in Europe has estimated that Liquidnet provides cost savings of \$9,697 per trade to each side relative to posting a block order on an exchange.

The issue of whether long-term investors should be able to designate the categories of counterparty with which they interact highlights these two concerns. Long-term investors should have the ability to determine the types of counter-parties with which they interact, and the fair access requirement should not be interpreted in a manner that would prevent long-term investors from making these types of determinations. As noted by the Commission in the rule proposal, various ATSS have introduced functionality to enable customers to determine the types of counter-parties with which they elect to interact.²² This type of functionality is important for institutional investors (and the beneficiaries of the accounts that they manage), which have a legitimate interest in protecting the confidentiality of their block order information.

In the original Regulation ATS proposing release, the Commission noted that “a denial of access might be unreasonable ... if it were based solely on the trading strategy of a potential participant.”²³ In the rule proposal the Commission recognizes that “... some NMS Stock ATSS segment order flow entered on the NMS Stock ATS according to various categories and allow subscribers to select the type of persons or order flow they want to trade or not trade against.”²⁴ The Commission further states in the rule proposal that it “... is not proposing to prohibit NMS Stock ATSS from segmenting their order flow,” but provides in a footnote that “... an ATS that crossed the fair access threshold and wished to segment its order flow could do so only in accordance with the fair access provisions of existing Rule 301(b)(5) of Regulation ATS.”²⁵ It is unclear from this discussion whether the Commission believes that allowing subscribers to select the categories of counter-parties with which they interact would be contrary to fair access.

The Commission should confirm that allowing subscribers to select the categories of counter-parties with which they interact is consistent with fair access. This interpretation would support the objectives of the rule proposal as subscribers could make order handling decisions based on the disclosures that they have received. Under the rule proposal, long-term investors will have access to additional information regarding the operation of all ATSS; the Commission can further the objectives of the rule proposal by affording institutions the opportunity to make elections based on that information.

In 2013, Liquidnet launched Liquidnet Transparency Controls, a website that our customers can access to make elections relating to the sources of liquidity with which they interact and the use of their trading data. Providing transparency to participants relating to the different sources of liquidity with which they can interact is of greater value if participants can make elections on whether to interact with these sources of liquidity. To that end, the Commission should not only permit ATSS to make these types of elections available to customers; the Commission

²² Rule proposal, at p. 297.

²³ Securities and Exchange Commission, “Regulation of Exchanges and Alternative Trading Systems – Proposed Rules,” Release No. 34-39884, File No. S7-12-98, April 17, 1998, <http://www.sec.gov/rules/proposed/34-39884.pdf> (accessed February 25, 2016), at p. 48.

²⁴ Rule proposal, at p. 297.

²⁵ Rule proposal, at p. 299.

should make clear its support for this type of process as one that is beneficial for long-term investors.

More generally on the subject of fair access, the Commission should take into account the function performed by an ATS when determining how to apply fair access to that ATS. As discussed above, the average execution size of the Liquidnet Negotiation ATS is between 172 and 265 times larger than the average execution size of the leading exchanges and ATSs. While execution of retail-sized orders can be considered a commodity service, block order execution has traditionally been, and continues to be, a customized service. This service has traditionally been performed by block trading desks; over time, electronic trading desks and ATSs have increasingly provided this service to long-term investors.

All institutional investors face the same challenge – how to execute large orders with reduced market impact. Different institutions have different investment and trading strategies and different approaches for meeting this challenge. It is important that broker-dealers have the necessary flexibility to work with institutions as they seek to achieve this objective, including through the crossing of block orders with other institutions, which would be considered ATS activity. An interpretation of fair access that would require institutional order flow to interact with all other types of order flow would be harmful to long-term investors. Similarly, requiring an ATS or its affiliated broker-dealer to provide the same functionality to broker-dealers as it provides to institutions would be harmful to long-term investors.

We further note that broker-dealers that operate an ATS often provide a level of integration between the affiliated broker-dealer and the ATS.²⁶ The Commission proposes that these relationships be fully disclosed. We support this proposal. At the same time, the fair access rule should not be interpreted in a manner that would prohibit these types of integrations where they are intended to benefit customers, as long as the method of integration is fully disclosed.

To sum up the discussion above, we do not suggest that the Commission has thus far taken an overly restrictive view of the fair access obligation. We are concerned, however, that the concept of fair access is not well defined and that an overly-restrictive interpretation of this requirement would be harmful to long-term investors. One approach to address this concern would be to provide that block executions would not count in determining whether an ATS has exceeded the fair access threshold.²⁷

In any event, prior to proposing any amendment to the fair access threshold, the Commission should provide further guidance relating to the types of activities that are consistent with fair access, taking into account the challenges faced by institutions in executing large block orders. At a minimum, the Commission should confirm that providing elections to participants relating

²⁶ See, for example, pp. 180-188 of the rule proposal.

²⁷ Under this proposal, block executions at an ATS would be excluded from the numerator, and block executions in all markets would be excluded from the denominator, when determining whether an ATS has exceeded the fair access threshold.

to the sources of liquidity with which they interact is consistent with the fair access obligation and beneficial for long-term investors.

Agreements with subscribers

The Commission proposes that ATSS disclose the differences in terms among subscribers to the ATS. We currently have in place over 1,500 subscriber agreements. Some of our agreements were signed more than 15 years ago. The agreements are not limited to a subscriber's participation in the ATS but also cover any trading activity by a subscriber through our broker-dealer.

It would require an extremely burdensome effort for minimal benefit to describe the various terms of these agreements. This provision should be tailored to require disclosure of any terms in a subscriber agreement that contradict or are inconsistent with the information in an ATS's Form ATS-N or where required to fully and accurately respond to a specific Form ATS-N question.

Outbound routing by ATSS

The ATSS operated by Liquidnet do not route orders to other execution venues. Rather, Liquidnet, Inc. routes orders to third-party execution venues. The equity ATSS operated by Liquidnet, Inc. are two out of multiple execution venues to which Liquidnet, Inc. can route orders. Based on this arrangement, our understanding is that the disclosures required in this section would not apply. If these types of disclosures did apply, they should apply to all broker-dealers, whether or not they operate an ATS.

Separately, Form ATS-N would require disclosure of routing by a broker-dealer to any affiliated ATS. We support requiring this type of disclosure. The method by which a broker-dealer interacts with the ATSS that it operates should be disclosed on Form ATS-N, but not the method by which the broker-dealer interacts with third-party execution venues (unless this disclosure is required of all broker-dealers, regardless of whether they operate an ATS).

Fees

Part IV, Item 12 of proposed Form ATS-N would require an ATS to disclose and describe its fee and rebate structure.²⁸ Where an ATS operator provides both brokerage and ATS services, our understanding is that the requirements relating to disclosure of fees would relate only to the fees that the ATS charges for its services and not the brokerage services. Otherwise, there would be unfair discrimination relative to broker-dealers that do not operate an ATS.

The Commission notes that in some cases the fee schedules employed by ATSS "are highly bespoke" and "it may not be practical or desirable to require an NMS Stock ATS to disclose the

²⁸ Rule proposal, at p. 338.

fee schedule applicable to each subscriber to the NMS Stock ATS.”²⁹ We agree with the Commission on this point. The execution of retail-sized orders is primarily a commodity service. In contrast, the execution of large block orders is a customized service, with different levels and types of service required for different customers (and different orders of the same customer) based on many factors, including: a customer’s trading workflow; the size of the customer’s orders relative to the liquidity in the relevant securities; the algo technology required by a customer for execution of its orders; the types of trading and operational support required by a customer; customized risk controls required by a customer; specific functionality required by a customer; potential counter-party risk; the customer’s back-office processes; the method of integration between the customer’s and the broker’s systems and the associated costs of the integration including payments to a third-party order management system vendor; the types of reports including pre and post-trade transaction cost analysis required by a customer; and order handling instructions including the requirement to balance buy and sell orders on a program order.³⁰ These are examples of the factors that are involved in the pricing of block orders and illustrate why the concept of a fixed fee schedule would not be practical or appropriate in this context.

Order display and execution access

Part IV, Item 4 of proposed Form ATS-N would require an ATS to provide certain information if the ATS “... displays orders in an NMS stock to any person other than employees of the NMS Stock ATS and executed 5% or more of the average daily trading volume in the NMS stock....”³¹ The information to be provided would include “... the manner in which the NMS stock ATS displays such orders on a national securities exchange or through a national securities association”³² The Commission advises in footnote 500 that “... an NMS Stock ATS filing a Form ATS-N would indicate ‘not applicable’ if the NMS Stock ATS had not triggered the volume thresholds under Rule 301(b)(3)(i) of Regulation ATS”³³

Under Rule 301(b)(3)(ii) of Regulation ATS, the order display requirement only applies where orders are “displayed to more than one person in the alternative trading system ...” The Commission clarified the application of this condition in the adopting release for Regulation ATS:

²⁹ Rule proposal, at pp. 340-341.

³⁰ As cited above, the average execution size on the Liquidnet Negotiation ATS is 166 times greater than the average execution size on the NYSE Group exchanges and 212 times greater than the average execution size on NASDAQ.

³¹ Rule proposal, at p. 347.

³² Rule proposal, at p. 347.

³³ Rule proposal, at p. 347.

“Finally, alternative trading systems are not required to provide to the public quote stream orders displayed to only one other alternative trading system subscriber, such as through use of a negotiation feature.”³⁴

The Commission should revise Part IV, Item 14 of proposed Form ATS-N to take this condition into account, such that the disclosure obligation of Item 14 would only apply where an ATS displays orders to more than one subscriber in securities where it has exceeded the applicable 5% threshold. The response of “not applicable” should similarly apply where an ATS, when it has exceeded the applicable 5% threshold in a security, displays orders in the security only to one other subscriber, such as through use of a negotiation feature.

Threshold for order display requirement

In the rule proposal, the Commission asks whether it should reduce the threshold for the order display requirement.³⁵ For the reasons discussed in this section, instead of reducing the threshold for the order display requirement, the Commission should provide a block exemption from such requirement.

The paramount interests protected by the Commission are those of long-term investors. Most long-term investors have their money invested through collective investment vehicles such as mutual funds and pension funds. The investment managers who invest these funds must execute large block orders while minimizing market impact costs. The introductory section of this comment letter describes the market impact cost savings and price improvement that a system like Liquidnet has been providing to long-term investors for the past fifteen (15) years.

Restricting investment managers to two choices – non-display and full display of their block order information – means reduced choice and higher trading costs for long-term investors. Investment managers require flexibility in how they display their block orders. This is why investment managers have requested, and ATSS have implemented, functionality that provides investment managers flexibility in how they display their block orders. The Commission should give careful consideration to functionality that investment managers have been requesting from ATSS, since these investment managers are the ones most directly tasked on a day-to-day basis with achieving best execution in the trading of block orders on behalf of long-term investors.

As an example, in November 2015 Liquidnet introduced targeted invitation functionality in Europe, and we plan to introduce this functionality in the US next month. This functionality allows an institution that places a committed block order to send notifications to other institutions based on objective criteria (for example, the recipient has executed in the stock

³⁴ Securities and Exchange Commission, “Regulation of Exchanges and Alternative Trading Systems – Final Rules,” Release No. 34-40760, File No. S7-12-98, December 8, 1998, <https://www.sec.gov/rules/final/finalarchive/finalarchive1998.shtml> (accessed February 25, 2016), at section IV.A.2.c.(ii)(A).

³⁵ Rule proposal, at p. 351-352.

within the prior five trading days). This functionality provides greater protections to the institution relative to the traditional broker-dealer IOI process because the institution sets the objective parameters that determine the eligible recipients of the notification. Dissemination of the sender's information is controlled relative to the traditional IOI process, providing the potential for a block execution with reduced market impact. This is functionality that Liquidnet developed specifically in response to requests from our institutional customers. Unfortunately, if we exceed the order display volume threshold in a particular security, we cannot offer this functionality for that security.

Considering how investment managers have indicated that they want choice in how to display their block order information, as opposed to lowering the threshold for the order display requirement, the Commission should instead adopt a block exemption from the order display requirement. At a minimum, the Commission should not lower the order display threshold. Lowering the threshold for the order display requirement would mean reduced choice, and higher trading costs, for long-term investors.

Market quality statistics

Under Part IV, Item 16 of proposed Form ATS-N, if an NMS Stock ATS

“publishes or otherwise provides to one or more subscribers aggregate platform-wide order flow and execution statistics of the NMS Stock ATS that are not otherwise required disclosures under Exchange Act rule 605 of Regulation NMS, it would be required to: (i) list and describe the categories of the aggregate platform-wide order flow and execution statistics published or provided; (ii) describe the metrics and methodology used to calculate the aggregate platform-wide order flow and execution statistics; and (iii) attach as Exhibit 5 the most recent disclosure of the aggregate platform-wide order flow and execution statistics published or provided to one or more subscribers for each category or metric as of the end of the calendar quarter.”³⁶

Liquidnet receives information requests on an ongoing basis from traders at the more than 800 firms that use our system. The traders request this information from Liquidnet and other ATSs to improve their trading performance. We are concerned that the requirements of Part IV, Item 16 would make the process of providing information requested by our customers more difficult.

We would recommend, as an alternative to the Commission's proposal, that the Commission designate specific execution statistics for all ATSs to provide, but if the Commission does adopt the requirements of Part IV, Item 16 as proposed, we would request that the Commission provide the following clarifications relating to this requirement:

³⁶ Rule proposal, at pp. 355-356.

- The proposal relates to “aggregate platform-wide market quality statistics” that an ATS publishes. The Commission should clarify that Item 16 would not apply where an ATS provides data to a customer relating to that customer’s specific usage of the ATS. For example, where an ATS discloses to a customer the percentage of the customer’s trades that were executed at the mid-point, our understanding is that the proposal would not require disclosure of this information because this is not an “aggregate platform-wide statistic.” Institutions must have access to this type of information to fulfil their best execution obligations, but making this type of information public could compromise an institution’s anonymity.
- The Commission should clarify that trade-specific data would not be subject to this filing requirement. Specifically, pre-trade and post-trade transaction cost analysis should not be covered by this proposal.
- The Commission refers to market quality statistics. Our understanding is that this would cover statistics that relate to execution quality and that other types of statistics would not be included. For example, if Liquidnet disclosed to a customer the percentage of customers that have used a specific product or product feature, we would not consider this to be a statistic relating to market quality. We would request that the Commission clarify this point.
- The proposal requires an ATS to attach “the most recent disclosure of the aggregate platform-wide order flow and execution statistics ... provided to one or more subscribers.” In some cases, a statistic could be provided by email to a customer. In other cases, a statistic could be provided in response to a questionnaire that an institution requires all broker-dealers to complete as part of the institution’s onboarding process or as part of an annual or other periodic due diligence process. In these cases, it should be permitted for the ATS to file the relevant statistic without filing the associated communication, as this could compromise the anonymity of the customer.

Identifying NMS Stock ATSs on execution reports

As a further step to enhance transparency, the Commission should require the public reporting of all individual ATS executions on an attributed basis. This reporting could be subject to a suitable delay period, such as 30 days. Attribution means that the ATS would be publicly identified for each execution. This data would be useful for third-party analysts, academics and others in evaluating execution quality across ATSs and other markets.

With this data, third-party analysts could conduct market impact cost analysis similar to that presently conducted by International Financial Services Limited for European equities, as described in the introductory section to this comment letter. This data is publicly available for

European equities because the Markets in Financial Instruments Directive mandates public attribution of the executing market in real-time.

Procedures to protect confidential information

Liquidnet does not object to the Commission's proposal to require that an ATS's procedures to protect confidential information be memorialized in writing.

At the same time, we are concerned that the requirements of Regulation ATS relating to protection of confidential information could be interpreted in a manner that would be harmful to long-term investors by prohibiting broker-dealers that operate ATSs from providing information to customers that the customers can use to evaluate and enhance their trading performance. For example, for Liquidnet's negotiation system, Liquidnet provides to participants a report of their positive action rates and the positive action rates of the contras with which they match. Positive action rate means the percentage of matches where a participant commences a negotiation or makes its indication active, thereby enabling the contra-party to commence a negotiation. Liquidnet can similarly provide historical reports to a customer relating to data that was previously visible to the customer through the Liquidnet desktop application. Liquidnet further provides reports to participants relating to post-trade and post-match price movement in the stocks where they have executed or matched. These are just examples of the various types of reports that Liquidnet provides, as described in our ATS filings.

In all cases, Liquidnet's data usage and the types of reports provided are disclosed to all system participants. Given that these types of reports are disclosed and are beneficial to customers, the Commission should not interpret Rule 301(b)(10) in a manner that would restrict these types of reports. In our view, the determining factor is whether the data usage is disclosed to participants. If the data usage is disclosed, participants can make an informed decision as to whether to participate in the trading system. The alternative of preventing broker-dealers that operate ATSs from providing useful information to customers would be harmful to long-term investors.

Cross-referencing

To the extent that certain of the questions on Form ATS-N request overlapping information, ATSs should be permitted in one response to Form ATS-N to reference another response in the same Form ATS-N. This would avoid duplication of information and improve the clarity of the Form ATS-N filing.

Narrative description of the amendment


The Commission advises in the rule proposal that "an NMS Stock ATS would also be required to provide a brief narrative description of the amendment at the top of Form ATS-N and a

redline(s) showing changes to Part III and or Part IV of proposed Form ATS-N.”³⁷ We agree with this approach as it would allow an ATS to distinguish between the explanatory text relating to a Form ATS-N amendment and the amendment itself. By analogy, a proposing or adopting release published by the Commission provides information relating to a rule proposal, but the release does not represent part of the rule that is being implemented or amended (other than the text of the proposed rule or amendment, typically provided at the end of the release). SRO rule proposals follow a similar format. In the same way, the approach proposed by the Commission would enable an ATS to distinguish between explanatory information relating to an amendment and the amendment itself.

As an example, if an ATS modifies a specific type of functionality, it would provide in the narrative a description of the new functionality and how it modifies the existing functionality. If the ATS subsequently modifies the same functionality, it should no longer be necessary to include on the Form ATS-N all the prior versions of the same functionality. This type of information would make the filing more difficult to read and would not provide additional value as readers would still have access to the prior ATS-N filings. The approach proposed by the Commission would allow an ATS to describe each amendment in the narrative that accompanies each Form ATS-N filing, while the Form ATS-N itself would set forth the current version of any functionality or process that is described.

Liquidnet appreciates this opportunity to comment on the Commission’s rule proposal to enhance ATS transparency. Please contact me at (██████████) with any questions or comments.

Very truly yours,



Howard Meyerson, General Counsel

³⁷ Rule proposal, at page 439.