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March 15, 2016

Via Electronic Mail (rule-comments@sec.gov)

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

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

Dear Mr. Fields:

KCG Holdings, Inc. ("KCG") appreciates the opportunity to submit comments to the Securities and Exchange Commission ("SEC" or "Commission") on its proposal to amend Regulation ATS (the "Proposal") with respect to alternative trading systems ("ATSS") that transact in stocks listed on a national securities exchange ("NMS Stock ATSS").¹

KCG supports the Proposal's fundamental objectives of enhancing operational transparency of NMS Stock ATSS and increasing awareness among market participants of potential conflicts of interest that ATS operators may encounter. We believe that requiring all NMS Stock ATSS to make uniform disclosure concerning their operations and potential conflicts of interest along with mandating that those disclosures be made public will empower market participants to make informed decisions about where to route their orders. We therefore endorse the policy goals underlying the Proposal and suggest certain limited modifications for improvements we believe are necessary to particular aspects of the proposed amendments.

¹ Securities Exchange Act Release No. 76476 (November 18, 2015) 80 FR 80998 (December 28, 2015) (the "Proposing Release").



I. KCG Background

KCG is a global financial services firm that offers market participants a range of services designed to address their trading needs across asset classes, product types and time zones. Among our offerings, KCG operates two SEC-registered alternative trading systems - KCG MatchIt and KCG BondPoint – both of which are leading providers of electronic trading solutions for market participants. KCG MatchIt ATS² transacts in NMS stocks and KCG BondPoint ATS³ offers electronic trading solutions in a variety of fixed income securities.

II. KCG Supports the Policy Goals Underlying the ATS Transparency Proposal

Summary of the Proposal. The SEC is proposing to amend the regulatory requirements for ATSs that transact in NMS stocks. Among other amendments, the Proposal would revise Regulation ATS to adopt new Form ATS-N, which would require an NMS Stock ATS to publicly disclose detailed information about its operations and the activities of the ATS's broker-dealer operator and its affiliates, and provide a process for the Commission to determine and declare Form ATS-N filings as effective or ineffective. The Commission is proposing these rule amendments to accomplish several goals, including:

- To enable market participants to better assess an ATS's operations and make more informed order routing decisions;

² KCG MatchIt ATS is an anonymous crossing venue that brings together a variety of sources on non-displayed liquidity from broker-dealers, including liquidity providers, institutional brokers, KCG's client market making business, KCG proprietary order flow, DMA order flow from third-party broker-dealers, and algorithmic order flow from third-party broker-dealers and KCG electronic trading.

³ KCG BondPoint ATS is a leading provider of electronic fixed income trading solutions that provides market participants with access to a centralized pool of liquidity and automated trade execution services. KCG BondPoint ATS assists the fixed income marketplace through product distribution, security analysis, price discovery, and automation of manual trading processes, which ultimately lead to a more transparent and efficient secondary bond market.



- To highlight for market participants potential conflicts of interest that may exist between the subscribers of an ATS and its broker-dealer operator; and
- To enhance the SEC's regulatory oversight of NMS Stock ATSs.⁴

Notably, the proposed revisions to Regulation ATS are in direct response to transparency concerns around operational complexities of NMS Stock ATSs. Therefore, the Commission is not at this time proposing to impose the new transparency regulations on ATSs that solely trade fixed income securities.

KCG Supports Heightened ATS Transparency. KCG has been a consistent and vocal proponent for enhancing ATS transparency, as exemplified by our disclosure approach for KCG MatchIt ATS. KCG MatchIt ATS voluntarily posts to KCG's public website documents and information relating to its operations and systems functionality, including the following materials: MatchIt Form ATS, MatchIt FIX Specifications, MatchIt Frequently Asked Questions, MatchIt Execution Protocols, and a Client Electronic Access and Trading Agreement.⁵ We believe that providing this level of public transparency regarding ATS operations and potential conflicts of interest allows market participants to make better informed decisions about utilizing the services of KCG MatchIt. Given this commitment to ATS transparency, we welcome revisions to Regulation ATS that would mandate similar openness by other ATSs and create a uniform set of public disclosures on Form ATS-N. We believe that implementing the underlying goals of the Proposal would materially benefit market participants by providing them with a better understanding of how their orders would interact, match, and execute on any given ATS and therefore allow them to determine the optimal venue for their order flow.

Limited Modifications to Certain Aspects of the Proposal Would Better Achieve the Stated Goals. While implementation of the proposed amendments to Regulation ATS would generally result in a step forward for ATS transparency and the evolution of equity market structure, we believe the current Proposal could be improved in several respects. In short, certain aspects of the Proposal are overly broad in that it

⁴ See SEC Press Release and Fact Sheet, November 18, 2015, entitled "SEC Proposes Rules to Enhance Transparency and Oversight of Alternative Trading Systems."

⁵ Available at <https://www.kcg.com/trading-venues/matchit/downloads/>.



would require an ATS to disclose a very granular level of information, much of which is superfluous for the purposes of market participants comparing and deciding where to send their orders. We are concerned that requiring an ATS to disclose excessive amounts of non-relevant detail about operations and affiliates may result in disclosures that are less transparent and more difficult for market participants to navigate and compare. We offer the following suggestions, which we feel would better calibrate the proposed amendments to both achieve the Commission's stated objectives (*i.e.*, setting operational transparency standards for NMS Stock ATSs and disclosing relevant conflicts of interest) while also preventing market participants from being inundated with ATS information that is not relevant for their purposes and difficult to reconcile.

Finally, KCG supports the SEC's decision to focus the Proposal on NMS Stock ATSs and to refrain from including fixed income ATSs within the scope of the amendments currently being considered. We concur with the Commission's view that the equities and fixed income markets are characterized by very different attributes and so it is critical to specifically tailor any potential revisions to the disclosure requirements for fixed income ATSs.

III. Suggested Modifications to Certain Aspects of the Proposal

A. The Advanced Notice Requirement

The Proposal contains what is referred to as an 'advance notice' requirement with respect to changes to a previously filed and effective Form ATS-N. Specifically, it would require an NMS Stock ATS to amend its effective Form ATS-N at least 30 days prior to implementing "a material change to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliate." SEC staff would have 30 days from such advance notice to declare the planned change as effective or ineffective.⁶

This is closer to an 'advance notice and approval' approach that may effectively result in a merit review process of ATS operations. Although the Proposing Release lists a number of scenarios likely to implicate a material change, it notes the list is

⁶ See proposed Rule 304(a)(2)(i) and (ii).



non-exhaustive and that an ATS must “consider all the relevant facts and circumstances, including the reason for the change and how it might impact the NMS Stock ATS and its Subscribers, as well as market participants that may be evaluating the NMS Stock ATS as a potential trading venue.”⁷ KCG believes this to be one of the most difficult and potentially unworkable obligations under the Proposal.

Imposing an advanced notice and approval requirement before an ATS can implement a material change may likely drive two outcomes. First, it may incent an NMS Stock ATS to err on the side of submitting Form ATS-N disclosures that are vague in order to provide it with sufficient operational flexibility to make subsequent changes without having to file and receive SEC approval. Vague descriptions will be less helpful to market participants who are assessing an ATS as a potential trading venue. Second, it may stifle ATS innovation as ATSs may be reluctant to iterate, employ new technologies, and make other changes that would be subject to an approval/disapproval review process by SEC staff.

We suggest maintaining the current advanced notice regime, which requires ATSs to file amendments 20 calendar days prior to implementing a material change to ATS operations and does not impose an effective/ineffective review process by SEC staff. Under this approach, ATSs would still be obligated to make advanced disclosures about material changes to their operations. Plus, given the breadth of disclosures under new Form ATS-N coupled with the fact that disclosures would be public as opposed to confidential, market participants would have access to a much greater level of information about ATS operations and changes than ever before.

B. Documents to be filed as Exhibits to Form ATS-N

The Proposal would require an NMS Stock ATS to attach as an exhibit to its Form ATS-N filing 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 (e.g., FIX protocol procedures, rules of engagement/manuals, frequently asked questions, marketing materials).”⁸ The Proposing Release notes that this

⁷ See Proposing Release at 81028.

⁸ See Proposed Form ATS-N, Part II, Exhibit 1.



requirement is driven by the Commission's concern that some ATSs may selectively share with certain subscribers important information about ATS operations and systems functionality – such as order matching procedures, priority rules, order types, and order entry and execution procedures – and its belief that ATS operational information should be available to all subscribers and other market participants on an equal basis.⁹

KCG concurs with the Commission's view that information concerning the operations and systems functionality of an NMS Stock ATS should be made available to all market participants and should not be selectively disclosed only to certain preferred subscribers. To that end, KCG MatchIt ATS publicly provides this level of transparency by posting its current Form ATS filing, along with other ATS operations and systems documents, which are available on our website.¹⁰ We therefore welcome amendments that would mandate transparency for all NMS Stock ATSs. While KCG agrees with the underlying objective of universal access to core ATS operational and systems information, we believe this requirement is currently drafted far too broadly. We therefore suggest tailoring this requirement to narrow its scope to achieve the goal of ATS operational transparency and to avoid inundating market participants with non-relevant information and unduly burdening ATS operators.

For example, the text of the obligation requires the filing of copies of any materials currently provided to subscribers or other persons related to the operations of the NMS Stock ATS. The term “any materials” is too sweeping as certain operational and systems documents and information are not relevant for purposes of facilitating ATS comparisons by market participants and may contain confidential information.¹¹ The current language would appear to capture information an ATS sent to a particular subscriber in response to that subscriber's request for data concerning its own

⁹ See Proposing Release at 81039-40.

¹⁰ See <https://www.kcg.com/trading-venues/matchit/downloads/>.

¹¹ Similarly, the requirement to file any ATS operational materials provided to “other persons” is overly broad as it would appear to capture any operational document ever created, such as internal emails between ATS staff and clearing staff concerning ATS operations as well as communications and information provided to regulators.



trading activity on the ATS. By filing such subscriber trading information as an exhibit to Form ATS-N, which will be made public by the SEC, the ATS would (i) expose confidential subscriber trading information, which is prohibited under Rule 301(b)(10) and (ii) risk inundating market participants with superfluous information for purposes of determining whether to trade on the ATS. Likewise, ATS internal documents that detail trade reporting logic would also appear to be captured under the current broad drafting of this requirement as would certain communications and information provided to regulators. Such information would not assist market participants in evaluating whether to submit order to flow to particular ATSs. The above illustrations are non-exhaustive examples of how the scope of the Proposal is overly broad and requires so much extraneous information and material that it will likely be counterproductive towards the Commission's goal of providing market participants with information relevant to making decisions about where to send their orders.

KCG suggests narrowing the scope of this obligation - as well as several other requirements set forth in proposed Form ATS-N - to more appropriately tailor the Proposal to meet the stated goal. Given the SEC's overriding concern that market participants be able to more readily assess the relative merits of several ATSs as potential trading venues, one narrowing approach would be to require all NMS Stock ATSs to create and distribute a standardized document set that includes core information regarding ATS operations and systems functionality. In addition to providing market participants with a single source of information concerning ATS operations, a universal document set would allow them to better compare and contrast the operations and systems functionalities of multiple ATSs.

Standard ATS operations and systems documents might be modeled after materials many ATSs already create and distribute to their subscribers - such as FAQs, term sheets, on-boarding documents, or user manuals. Regardless of form, the SEC should consider requiring standard documents that contain the following types of ATS operational and systems details, among others: order matching procedures; priority rules; order types; order entry and execution procedures; criteria for order flow classifications; and pricing schedules. Importantly, ATS operators should be permitted to furnish universal operations and systems materials via a web link and updates to these materials should not be subject to the proposed effective/ineffective review and approval process. Otherwise, requiring an ATS to submit planned



amendments to ATS operations and systems to the proposed advanced notice and approval process would cause lengthy delays and stifle ATS technological innovation.

C. Disclosures Concerning the Activities of Broker-Dealer Operators and their Affiliates

The Proposal would require an NMS Stock ATS to disclose whether the broker-dealer operator or any of its affiliates operate or control any non-ATS trading center that is an OTC market maker or executes orders in NMS stocks internally by trading as principal or crossing orders as agent. If so, the ATS would have to identify the non-ATS trading center and provide a “description of any interaction or coordination between the non-ATS trading center and the NMS Stock ATS.”¹² According to the Proposing Release, the Commission is concerned that the broker-dealer operator of an ATS could place the interests of its or its affiliates’ non-ATS trading center ahead of the interest of the operations of the ATS and its subscribers. The Commission preliminarily believes that the proposed disclosure may help inform market participants about the non-ATS trading center interaction with subscriber orders on the NMS Stock ATS and potential incentives and opportunities for information leakage.¹³

KCG agrees with the goal of highlighting potential conflicts of interest faced by broker-dealer operators of NMS Stock ATSs and their affiliates in connection with the ATS. Thus, we endorse the requirement to identify non-ATS trading centers managed by the ATS operator or its affiliates that interact with the ATS. We do, however, believe the scope of this requirement as currently drafted is too broad and should be narrowed.

First, instead of requiring an open-ended description of “any interaction or coordination,” which unfortunately may yield very divergent and lengthy narratives by ATS operators that market participants will have difficulty reconciling, the requirement should be revised to request answers to a uniform set of questions

¹² See proposed Form ATS-N, Part III, Items 1 and 2.

¹³ See Proposing Release at 81045.



presented in a progressive yes/no format.¹⁴ This would allow subscribers to better compare the responses of multiple ATSs under consideration. It would also prevent ATSs from submitting lengthy narrative responses that are likely to be over-inclusive and vague in an effort to avoid regulatory second-guessing about omitting potentially material information and maintain operational flexibility and avoid the 30 day delay involved with the amendment filing process. Second, the disclosure should be limited to non-ATS trading centers that interact with or exchange information with the ATS. Third, it is imperative for the Commission to clarify that the interaction between the NMS Stock ATS and any non-ATS trading center may be subject to change and the ATS operator does not need file and receive SEC approval before implementation.

D. Disclosures Concerning Products or Services Offered to Subscribers

The Proposal would require an NMS Stock ATS to disclose whether the broker-dealer operator or any of its affiliates offer subscribers any products and services used in connection with trading on the NMS Stock ATS, including for example algorithmic trading products and market data feeds. If so, it would require descriptions regarding the types of services offered and whether the terms and conditions are the same for all subscribers.¹⁵

KCG supports disclosures concerning ATS-linked products and services. We do, however, suggest revising this requirement to clarify that it only applies to products and services offered to subscribers as part of their ATS subscription. Put another way, distinct products and services (*e.g.*, algorithms, market data feeds, FIX lines, *etc.*) provided by an affiliate to a client - who also happens to be an ATS subscriber - but which are not directly linked to the ATS subscription and that the client/subscriber ultimately may or may not use to trade on the ATS should not be captured by this requirement. In many cases an ATS operator may be unaware of products and services separately provided by an affiliate to a client that are entirely independent from and may pre-exist the client's ATS subscription.

¹⁴ See Letter from Fidelity Investments to the Commission commenting on the Proposal (February 26, 2016) for an example of a progressive yes/no format.

¹⁵ See proposed Form ATS-N, Part III, Item 3.



E. Disclosures Concerning Trading Activities on the NMS Stock ATS and the Use of Smart Order Routers and Algorithms

The Proposal would require an NMS Stock ATS to disclose whether the broker-dealer operator, or any of its affiliates, enters orders or other trading interest on the NMS Stock ATS. If so, it would require details on how they trade and whether subscribers can be excluded from interacting or trading with such orders or trading interest.¹⁶ It would also require disclosure of whether the broker-dealer operator, or any of its affiliates, use a smart order router or algorithm to send or receive subscriber orders or other trading interest to or from the NMS Stock ATS and, if so, details about how the smart order router or algorithm interacts with the ATS.¹⁷

KCG supports the disclosure of potential trading activity on the NMS Stock ATS by the broker-dealer operator and its affiliates. We believe, however, that the requirement should be revised to allow for a series of progressive yes/no responses that provide requisite transparency while also allowing subscribers to more readily compare and contrast the practices of numerous ATSs. We also believe the disclosure requirement, as currently drafted, would pose significant challenges to ATS operators to maintain up to date disclosures based on ongoing business changes. For example, if a broker-dealer operator provides a disclosure (*e.g.*, that it routes orders to the ATS from its algorithmic business) and the data center from which the algorithmic business operates subsequently experiences systems issues that force it to stop routing orders to the ATS, this disclosure would no longer be accurate. Furthermore, the broker-dealer operator would not be in position to meet the 30 day advanced notice and approval regime set forth in the Proposal. Therefore, it is imperative for the Commission to clarify that certain Form ATS-N disclosures may be subject to immediate change without notice.

Similarly, we do not oppose disclosure of smart order routers or algorithms used by the broker-dealer operator or its affiliates to trade on the ATS to the extent that these products possess information about the ATS based on their affiliation that other unaffiliated routers and algorithms do not possess. Again, we believe that the

¹⁶ See proposed Form ATS-N, Part III, Item 5.

¹⁷ See proposed Form ATS-N, Part III, Item 6.



requirement should be revised to allow for a series of progressive yes/no responses instead of subjective descriptions as it will provide requisite transparency and allow for subscribers to more readily compare among numerous ATS. We also believe a more granular disclosure requirement would pose the same challenges to maintain up to date disclosures based on business changes as described above.

F. Disclosures Concerning the Manner of Operations of the NMS Stock ATS

Part IV of proposed Form ATS-N would require that broker-dealer operators of NMS Stock ATSs include various disclosures relating to the manner of operations of the NMS Stock ATS.¹⁸ According to the Proposing Release, the Commission preliminarily believes that these proposed disclosure requirements would significantly improve the opportunity for market participants and the Commission to get a “full picture” and better understand the operations of NMS Stock ATSs.¹⁹

As previously noted, KCG MatchIt ATS posts its current Form ATS and related operations and systems documents on our website. We therefore support mandating uniform disclosures by NMS Stock ATSs regarding their operations and systems functionality. We offer the following suggestions to better tailor the proposed disclosures to achieve the stated goal of providing market participants with useful information for ATS order routing decisions and also to avoid information overload.

The Proposal would require ATS subscriber information, including information relating to subscriber eligibility, terms and conditions of use, types of subscribers, arrangements with liquidity providers, and circumstances where an ATS access may be limited or denied.²⁰ First, we believe the requested information is overly broad and may be subject to interpretation. We recommend the information be rephrased from a request for descriptions - which would yield lengthy and hard to compare information among different ATS operators - to a more simple and user-friendly yes/no format. Second, there appears to be overlap between several requested items, including the information requested under “eligibility” and “limitation and denial of

¹⁸ See proposed Form ATS-N, Part IV.

¹⁹ See Proposing Release at 81060.

²⁰ See proposed Form ATS-N, Part IV, Item 1.



services.” The Commission should revisit and clarify the request. Third, the terms “types of subscribers” and “liquidity providers” should be specifically defined.

G. KCG Concurs with the Commission’s Approach for ATSS that Effect Trades in Fixed Income Securities

The Commission preliminarily believes the enhanced disclosure requirements should apply only to ATSS that transact in NMS stocks and it is not recommending to extend such requirements to ATSS that trade fixed income securities. In the SEC’s view, the proposed amendments to Regulation ATS have been formulated “in direct response to specific transparency concerns related to the operational complexities of the NMS Stock ATSS and market participants’ general inability to compare NMS Stock ATSS to one another and the national securities exchanges,” therefore the Proposal does not cover fixed income ATSS.²¹

To begin, KCG supports operational transparency for all ATSS, including those that effect trades in fixed income securities. To that end, KCG voluntarily makes execution protocols for our fixed income ATS, KCG BondPoint ATS, available to subscribers. Nonetheless, KCG concurs with the Commission’s assessment that the equities markets and fixed income markets are at very different stages of development and thus the enhanced disclosure requirements for NMS Stock ATSS under the Proposal should not extend to fixed income ATSS.²²

One of the primary reasons for not extending the heightened disclosure requirements to fixed income ATSS is that it would place these platforms at a competitive disadvantage as compared with non-ATS trading systems that trade fixed income securities and would not be subject to the increased obligations.

²¹ See Proposing Release at 81017.

²² The SEC notes the following differences between the equities and fixed income markets: order execution in the fixed income markets are less reliant on speed, automation and electronic; fixed income ATSS typically offer less complex order types, sometimes restrict incoming order to limit orders, and executions often involve negotiation; municipal and corporate fixed income markets tend to be less liquid than equities markets with slower execution times and less complex routing strategies; the majority of trading in fixed income securities occurs on the bilateral market. See Proposing Release at 81017.



Forcing fixed income ATSs to seek and obtain regulatory approval before making adjustments to their platform would impose delays and would likely impact innovation and competition with non-ATS fixed income systems. It would also impose additional compliance oversight obligations and costs that non-ATS trading systems would not be subject to. In addition, imposing the structure contemplated under the Proposal may impact the formation of new fixed income ATSs and alter the continuing trend towards electronic trading of fixed income securities.

Given the rapid and continued evolution of the market for government securities, the Commission also asks whether ATSs that effect transactions in fixed income securities that are government securities should be subject to increased regulation and/or operational transparency requirements.²³ For similar reasons as noted above, KCG believes that ATSs that trade government securities should not be subject to increased regulation as such requirements would place them at a disadvantage compared to non-ATS trading systems that trade government securities and that would not be subject to increased obligations.

* * *

KCG appreciates the opportunity to comment on the Proposal. Please do not hesitate to contact me at [REDACTED] or [REDACTED] if you have questions regarding any of the comments provided in this letter.

Sincerely,

John A. McCarthy
General Counsel

²³ See Proposing Release at 81018.



cc: The Honorable Mary Jo White, Chair
 The Honorable Michael S. Piwowar, Commissioner
 The Honorable Kara M. Stein, Commissioner
 Stephen Luparello, Director, Division of Trading and Markets
 Gary Goldsholle, Deputy Director, Division of Trading and Markets
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