

MEMORANDUM

TO: File No. S7-23-15

FROM: Derek James
Special Counsel
Office of Market Supervision, Division of Trading and Markets
U.S. Securities and Exchange Commission

DATE: May 5, 2016

SUBJECT: Meeting with Representatives from Liquidnet, Inc.

On April 28, 2016, representatives from the U.S. Securities and Exchange Commission (“SEC”) met with representatives from Liquidnet, Inc. (“Liquidnet”). The SEC representatives were David Shillman, Tyler Raimo, Jennifer Dodd, David Garcia, Derek James, Marsha Dixon, Eugene Hsia, Matthew Cursio, and Megan Mitchell from the Division of Trading, and Markets, and Claudia Moise and Salil Pachare from the Division of Economic and Risk Analysis. The Liquidnet representatives were Howard Meyerson, David Spotts, Richard Franco, Adam Sussman, and Thomas Scully. The participants in the meeting discussed, among other things, regulation of NMS Stock Alternative Trading Systems [Release No. 34-76474].

Attachment

SEC RULE PROPOSAL ON ATS TRANSPARENCY

MEETING WITH SEC DIVISION OF
TRADING AND MARKETS

Liquidnet, Inc.
April 28, 2016

liquidnet 

LIQUIDNET BACKGROUND

LAUNCHED

2001

GLOBAL MEMBER FIRMS

800+*

MEMBER AUM

\$14T*

MARKETS

44*

\$81B

**AVERAGE DAILY
GLOBAL LIQUIDITY****

42K

AVERAGE EXECUTION SIZE
in shares (Liquidnet
Negotiation ATS)**

\$1.6M

AVERAGE EXECUTION SIZE
in principal (Liquidnet
Negotiation ATS)**

7,831

**GLOBAL DISTINCT
SYMBOLS IN THE POOL**
(average per day)**

* As of April 25, 2016.

** Q1 2016.

LIQUIDNET BACKGROUND

LIQUIDNET FIXED INCOME

- **Launched dark pool September 29, 2015**
- **Performance Stats**
 - Active Firms: 170
 - Total Volume Traded: \$1.8B*
 - Average Trade Size: \$2.3M*

* September 29, 2015 – April 22, 2016.

LIQUIDNET CURRENT BUSINESS

- **Global headquarters in New York; regional offices in:**
 - London
 - Toronto
 - Sydney
 - Hong Kong
 - Singapore
 - Tokyo
- **Currently operate three ATSs in the US:**
 - Liquidnet Negotiation ATS (equities)
 - Liquidnet H2O ATS (equities)
 - Liquidnet Fixed Income ATS (fixed income)
- **Also provide electronic agency trading services for institutional block orders**

LIQUIDNET AVERAGE EXECUTION SIZE

Average execution size for 2015 compared to the leading exchanges and ATSs:

Venue	Average execution size for 2015	Liquidnet multiple
Liquidnet Negotiation ATS	40,089 shares	
NYSE Group	241 shares*	166
NASDAQ	189 shares	212
CS Crossfinder	182 shares	220
UBS PIN	157 shares	255
IEX	229 shares	175

68%

For any US stock traded by Liquidnet during a trading day, the % of time we traded the 1st or 2nd largest print on the day in that stock.**

* All third-party data on this slide is cited in Liquidnet's February 26, 2016 comment letter on the ATS rule proposal, <http://www.sec.gov/comments/s7-23-15/s72315-16.pdf>.

** Q1 2016.

LIQUIDNET COST SAVINGS

- Block executions between institutions are the most efficient type of execution and provide the largest cost savings to long-term investors
- Cost savings analysis by Intelligent Financial Systems Limited (IFSL) for Liquidnet Europe for February 2016:

Average trade size	€ 918,071*
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Cost savings (in basis points)	104.88 basis points
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Cost savings (in Euros, per execution, each side)	€ 9,628
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Cost savings per execution, each side (converted to US dollars)	\$ 10,880**
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**http://www.if5.com/_LiquidMetrix/!Downloads/DarkPool/LiquidMetrix%20Guide%20to%20European%20Dark%20Pools%202016%2002.pdf*

*** Conversion rate of 1.13:1, as of April 26, 2016.*

PRICE IMPROVEMENT

During 2015, Liquidnet executed 97% of Member and customer executions in US equities at the mid-point of the NBBO

OUTLINE OF DISCUSSION POINTS ON SEC RULE PROPOSAL

- I. LIQUIDNET SUPPORTS ENHANCED TRANSPARENCY**
 - Our view and current business/operational efforts
- II. DISCLOSURE AND FILING ISSUES**
 - Definition of materiality
 - Filing process for material changes
 - Requirement to make material change filings public in advance
 - Filing of materials provided to subscribers
 - Public filing of exhibits
 - Agreements with subscribers
 - Fees
 - Market quality statistics
 - ATS filing for non-NMS stocks
 - Process for approving new ATS filings
 - Cross referencing
- III. PROCEDURES TO PROTECT CONFIDENTIAL INFORMATION**
- IV. FAIR ACCESS**
- V. ORDER DISPLAY**

TRANSPARENCY

LIQUIDNET SUPPORTS ENHANCED TRANSPARENCY

- Liquidnet supports the SEC's objectives to enhance transparency of ATS activities
- For institutions to achieve best execution of their customer orders, they must have transparency into how the various markets operate and how their orders are handled
- Transparency builds trust from customers
- Liquidnet's transparency initiatives include:
 - Liquidnet Transparency Controls
 - Web-based portal used by Liquidnet's asset management customers to make elections relating to sources of liquidity and use of trading data
 - Transparency Working Group
 - Meets weekly to consider and advise the business on disclosure and data usage issues
 - Includes representatives from Legal, Compliance, Product, Sales, Marketing, Operations, and Risk Management.
 - Documentation
 - Form ATS filing publicly available; global trading rules; Order Handling Q and A document updated quarterly; Member website

TRANSPARENCY

LIQUIDNET SUPPORTS ENHANCED TRANSPARENCY

- Liquidnet expends significant resources to maintain its current transparency initiatives
- Transparency means disclosing information to competitors that would not otherwise be disclosed
- Overall, the benefits of transparency outweigh the costs, not just for customers, but also for ATS operators

DISCLOSURE AND FILING ISSUES

DEFINITION OF MATERIALITY

- Liquidnet agrees with the Commission's proposed standard for materiality: "substantial likelihood that a reasonable participant would consider the change important when evaluating the NMS Stock ATS as a potential trading venue."
- Concerned about the eight enumerated "scenarios that are particularly likely to implicate a material change"
 - In particular, after significant new functionality is introduced, we sometimes need to modify that functionality on an expedited basis based on customer feedback or unanticipated workflows or scenarios

DISCLOSURE AND FILING ISSUES

FILING PROCESS FOR MATERIAL CHANGES

- Liquidnet agrees with the Commission's approach to require prior notice of material changes, but not prior approval
- Increasing the notice period from 20 to 30 days would impede our ability to introduce new functionality
- At the time of filing, we often can't predict the exact release date; further, for risk management and to validate functionality, we sometimes introduce new functionality in stages over a period of two to three weeks
 - An ATS should be permitted to disclose that new functionality will take effect "on or after" a specified date
- The filing process should take into account present and future state
 - Liquidnet currently maintains a restated filing with all functionality that is currently in effect and one or more material change filings that describe future changes
 - Example:
 - Liquidnet intends to introduce a material change on June 30 and must file a Form ATS-N amendment by May 31; What should the Form ATS-N provide during June 2016? The current functionality? The future functionality? Both?

DISCLOSURE AND FILING ISSUES

REQUIREMENT TO MAKE MATERIAL CHANGE FILINGS PUBLIC IN ADVANCE

- In many cases, Liquidnet files material changes well in advance of the 20-day prior notice date
 - In the past, we have received feedback from ATS staff on these filings that has resulted in improved disclosure
- Liquidnet is concerned that the requirement to make material change filings public upon filing would dis-incentivize Liquidnet from filing material changes in advance of the required filing date
- We propose that these filings be made public upon the stated implementation date for the new functionality
- More generally, if the Commission moves forward with a requirement to make material change filings public in advance, the Commission should provide a process to allow an ATS to submit draft filings and obtain feedback from the Commission in advance of the required filing date

DISCLOSURE AND FILING ISSUES

FILING OF MATERIALS PROVIDED TO SUBSCRIBERS

- Form ATS-N would require ATSs 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”
 - This could require the filing of any email or IM communication by an ATS employee to a customer
 - The Commission should instead identify specific categories of documents that should be filed as Exhibits
 - See, for example, documents referenced by the Commission in the rule proposal (FIX protocol procedures, rules of engagement, user manuals, frequently asked questions and marketing materials)
 - Filing requirement should only apply to documents still being used by the ATS operator

DISCLOSURE AND FILING ISSUES

PUBLIC FILING OF EXHIBITS

- The requirement for public filing of exhibits as proposed raises confidentiality and security issues
 - Example: some documents have port numbers
- It would also result in less information being filed with the Commission
- We propose that exhibits be made public only where required to accurately respond to the questions on Form ATS-N

DISCLOSURE AND FILING ISSUES

AGREEMENTS WITH SUBSCRIBERS

- The Commission proposes that ATSs disclose the differences in terms among subscribers to the ATS
 - We currently have in place 1,500+ subscriber agreements
 - Some were signed more than 15 years ago
 - The agreements are not limited to a subscriber's participation in the ATS and also cover any trading activity through our broker-dealer
- We propose tailoring this provision 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

DISCLOSURE AND FILING ISSUES

FEES

- We agree that all fees for a customer should be disclosed to that customer in advance. We do not agree with requiring public disclosure of this information.
- Pricing takes into account brokerage and ATS services; it is unfair to require broker-dealers that operate ATSs to provide disclosure that is not required for broker-dealers that do not operate ATSs

DISCLOSURE AND FILING ISSUES

MARKET QUALITY STATISTICS

- We recommend that the Commission not proceed with the proposal relating to market quality statistics because it would impose an administrative burden for Liquidnet to file each time we provide our customers with data they request to improve their trading performance
- If the Commission moves forward with this proposal, we would recommend the following clarifications:
 - The filing requirement would not apply where an ATS provides data to a customer relating to the customer's specific usage of the ATS
 - Trade-specific data (including TCA) would not be covered by this requirement
 - The proposal only applies to statistics relating to execution quality; statistics relating to usage of products or product features would not be covered
 - Where a statistic is provided as part of a communication to a customer, the statistic can be filed with the Commission without reference to the communication

DISCLOSURE AND FILING ISSUES

ATS FILINGS FOR NON-NMS STOCKS

- An ATS should have the option to include non-NMS stocks in its Form ATS-N to avoid having to maintain multiple filings

PROCESS FOR APPROVING NEW ATS FILINGS

- An ATS should have the ability to make material changes during the 120-day period for new ATS-N filings without delaying the approval of the new Form ATS-N filing

CROSS-REFERENCING

- 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

CONFIDENTIAL INFORMATION

PROCEDURES TO PROTECT CONFIDENTIAL INFORMATION

- Liquidnet supports the requirement that an ATS document in writing its procedures to protect confidential information
- The Commission should clarify that ATSs can provide information to customers that the customers can use to evaluate and enhance their trading performance, as long as this is disclosed to all customers in advance
 - Examples:
 - Report showing a customer's "positive action rate" (PAR) through the system and the aggregate PAR of the contras with which they match
 - Reports to a customer that consist of data that was previously visible to the customer through the trading system
 - Reports to a customer showing post-trade and post-match price movement in the stocks where they have executed or matched
 - Reports showing aggregate usage of Liquidnet products or product features and success rates

FAIR ACCESS

FAIR ACCESS

- Institutions should have the ability to determine the sources of liquidity with which they interact for block order execution, as institutions seek to reduce market impact and achieve best execution
- An ATS should be permitted to provide functionality specifically for institutions executing block orders, to assist the institutions in reducing market impact and achieving best execution
 - Exchanges and ATSs can provide functionality specifically for brokers and not institutions; the reverse should also be permitted
- Block executions should be excluded for determining whether an ATS has exceeded the ATS fair access threshold

ORDER DISPLAY

ORDER DISPLAY

- Disclosure requirement
 - The Commission should revise Part IV, Item 14 of proposed Form ATS-N to clarify 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 in a security
- Exemption for block orders
 - To assist institutions as they seek to reduce market impact and achieve best execution of their block orders, institutions should have flexibility as to how to display their block orders
 - The Commission should provide an exemption from the order display rule for block orders

QUESTIONS?