TradeStation

March 30, 2023

Submitted Electronically

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: File No. S7-29-22; Release No. 34-96493; *Disclosure of Order Execution Information*

File No. S7-30-22; Release No. 34-96494; *Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders*

File No. S7-31-22; Release No. 34-96495; *Order Competition Rule*

File No. S7-32-22; Release No. 34-96496; *Regulation Best Execution*

Dear Ms. Countryman:

TradeStation Securities, Inc. ("TradeStation") appreciates the opportunity to provide comments to the U.S. Securities and Exchange Commission ("the Commission) in response to the above-referenced rule proposals (the "Proposals").[1]

A. Introduction

TradeStation is registered with the Commission as a broker-dealer. We offer self-directed traders and investors award-winning trading platforms with broad multi-asset capabilities supported by our execution, self-clearing and other online brokerage services primarily in the equities and equity options markets. TradeStation's proprietary technology is available on desktop, web and mobile. We connect directly to stock exchanges and other electronic markets for both market data distribution and trade order placement for our clients, and we also self-clear our clients' equities and equity options trades, and custody client cash and other assets.

Since 2001, TradeStation's robust platform and trading analytics capabilities have attracted sophisticated and active retail and institutional traders. Many of our clients leverage proprietary analytical and execution tools to develop, test and implement their own trading strategies. In October 2019, TradeStation started offering zero commission stock and ETF trading to remain competitive with other broker-dealers that also started offering commission-free trading at around the same time. TradeStation's decision to offer zero commission trading

[1] Exchange Act Release No. 96493, 88 FR 3786 (Jan. 20, 2023) (*Order Execution Information*); Exchange Act Release No. 96494, 87 FR 80266 (Dec. 29, 2022) (*Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders*); Exchange Act Release No. 96495, 88 FR 128 (Jan. 3, 2023) (*Order Competition Rule*); Exchange Act Release No. 96496, 88 FR 5440 (Jan. 27, 2023) (*Regulation Best Execution*).

led to a loss of transactional revenue, leaving payment-for-order-flow ("PFOF") as the primary transactional revenue source for its online self-directed equities trading business. This transition was possible primarily because broker-dealers, like TradeStation, routed (and continue to route) a large percentage of their clients' non-directed marketable and marketable limit equities order flow to off-exchange dealers ("wholesalers") that process those orders faster and more efficiently than the national exchanges.

As explained below, TradeStation believes the Commission's proposed *Order Competition Rule* (proposed Rule 615) and proposed *Regulation Best Execution* (proposed Rules 1100, 1101 and 1102) should not be adopted because they will make it more costly and less efficient for retail traders to access and trade the equities and options markets. We agree with the March 24, 2023 Comment Letter submitted by Cboe Global Markets, State Street Global Advisors, T. Rowe Price, UBS Securities, LLC and Virtu Financial, Inc. where they collaboratively reason that "*market structure reforms should be an iterative, targeted, and empirically-driven process to reduce the risk of jeopardizing the substantial benefits already provided to investors and issuers by the current market structure and to avoid introducing unanticipated operational risks and complications associated with sweeping changes to the marketplace.*"

TradeStation generally supports the other two proposals, *Regulation NMS: Minimum Pricing Increments, Access Fees* and *Transparency of Better Priced Orders* and *Disclosure of Order Execution Information*, subject to some modifications, as explained below.

B. <u>Order Competition Rule</u>

TradeStation supports reasonable regulation designed to improve both the experience and quality of executions for retail traders and investors. However, proposed Rule 615 would accomplish neither of those objectives. Under proposed Rule 615, wholesalers become "restricted competition trading centers" that must send orders to qualified auctions operated by "open competition trading centers" (ATSs or Exchanges), restricting them from executing marketable retail orders internally unless the orders are sent to an auction or otherwise qualify for an exception.[2]

If adopted, proposed Rule 615 would materially disrupt the current order routing model which has consistently returned millions of dollars in price improvement to retail traders and investors. TradeStation does not believe that Rule 615 will "*benefit individual investors by promoting competition and transparency to enhance the opportunity for their orders to receive more favorable prices.*"[3]

The Commission concedes, as it must, the benefits of the current order-routing model on page 8 of Exchange Act Release No. 96495:

> The primary benefit of segmentation for individual investors is that it can provide an opportunity for their low-cost orders to be executed at better prices than those generally available on

[2] The exceptions include: (1) no qualified auction is being conducted on an open competition venue at the time the order was submitted; (2) orders over $200k in notional value; (3) orders can be executed at midpoint or better; (4) customer selects a limit order more favorable than the midpoint; and (5) fractional shares.

[3] *See Proposed Rule to Enhance Order Competition Fact Sheet.*

national securities exchanges, a practice known as "price improvement."

TradeStation believes that the Commission's novel order-routing proposal would give institutional traders more information than retail traders resulting in adverse selection where certain order types, like those originating from active retail traders (many of whom trade through broker-dealers like TradeStation and inject important liquidity into the financial markets), will likely receive inferior executions because of the lack of anonymity in the proposed auction process.

TradeStation's execution quality data convincingly supports preserving the current market structure model. Our execution quality experts regularly and rigorously analyze the effective-versus-quoted ratio ("EFQ")[4] and other factors and recommend routing changes based solely on how the wholesalers and exchanges compete for order flow, not based on PFOF. Wholesalers and exchanges that deliver better EFQ ratios receive more order flow. Wholesalers and exchanges that deliver inferior EFQ ratios may improve the quality of their executions and/or retail liquidity programs if they want to have more orders routed to them. Since the national exchanges typically execute orders at the National Best Bid and Offer ("NBBO"), their EFQ ratios hover around and sometimes exceed 100%, a ratio considerably higher than the EFQ ratio consistently delivered by the wholesalers with whom TradeStation conducts its business. TradeStation data also confirms that traders and investors are more than twice as likely to have wholesaler-routed orders executed at the midpoint or better versus orders routed directly to the national exchanges.

TradeStation's execution quality metrics underscore the benefits of routing retail clients' non-directed orders to wholesalers for execution, having returned millions of dollars in price improvement.[5] Had the same orders been routed directly to the national exchanges, our clients would have experienced considerable price dis-improvement.[6] We know this because, since May 2019, we have routed a small percentage of our clients' non-directed equities orders to national exchanges to compare execution quality. Our results confirm that wholesalers offer faster executions, tighter spreads and significant price improvement opportunities versus the national exchanges:[7]

	Execution Speed	Realized Spread	At-Or-Better %	Price Improvement %
Wholesalers	0.334	0.004	88.08%	33.43%
National Exchanges	0.855	0.0185	77.28%	5.56%

[4] The EFQ ratio compares the average effective spread with the quoted spread (the difference between NBBO offer and NBBO bid at time of order entry). When an order is executed exactly at the NBBO, then the EFQ ratio is 100%. Lower ratios indicate executions below the NBBO and, thus, greater cost savings to traders and investors.
[5] In 2022, TradeStation clients realized over $17 million in net price improvement (price improvement minus slippage).
[6] TradeStation does not believe that the CAT rebate base competitive shortfall estimates published in Exchange Act Release No. 96495 warrant such a dramatic rule change, and support SIFMA's Freedom of Information Act (FOIA) request to make public the underlying CAT data upon which the Commission relies. *See* SIFMA Comment Letter dated February 8, 2023.
[7] Data is obtained from S3 Matching Technologies LP.

TradeStation also challenges the Commission's estimates of the initial and ongoing technological burdens and financial costs should proposed Rule 615 be adopted in its present form. These estimates fail to address how the considerable added burdens and costs will have to either be absorbed by broker-dealers or passed on to the retail trader and investor, possibly through reinstatement of commissions or the creation of new types of fees or charges. TradeStation shares the National Association of Securities Professionals' ("NASP") concern that the *"proposals will combine to introduce new frictions into the markets that may [h]arm (sic) retail investors" and that "the added costs and reduced revenues for market intermediaries . . . will likely be passed along to these investors, further raising costs to invest, and likely disenfranchising many individuals from participating in the stock market."*[8]

The Commission also ignores the profound impact these sweeping market structure rule changes will have on smaller broker-dealers, like TradeStation. Smaller broker-dealers will incur disproportionally greater costs and impacts relative to revenue than larger broker-dealers where online trading revenue represents a much smaller part of overall revenue, allowing some of the larger broker-dealers to offer zero-commission online trading without PFOF as a loss leader to attract prospective clients to their more profitable product and service offerings. By making it cost-prohibitive for smaller, new or up-and-coming broker-dealers to compete, retail and institutional traders and investors may lose the benefit of innovations and improvements in product and service offerings that get introduced by smaller participants and ultimately get adopted industry wide. The introduction of direct access trading in the late 1990s and early 2000s is a prime example of this. An unintended consequence of the proposed *Order Competition Rule* may be the creation of an oligopoly of a handful of large broker-dealers through which online retail trading can be conducted.

Finally, proposed Rule 615 and *Regulation Best Execution* are mutually exclusive. Under Rule 615, broker-dealers would be required to route orders to auctions held by order competition centers thus making it impossible for them to comply with *Regulation Best Execution* where they would have the duty to exercise reasonable diligence to ascertain the best market for a security, and then buy or sell the security in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. This catch-22 dilemma can be rectified only with a Commission vote to not adopt the conflicting rules as proposed.

C. Regulation Best Execution

Proposed *Regulation Best Execution* is redundant, overbroad and should not be adopted by the Commission. Execution quality is already competently regulated by existing execution quality rules, including FINRA Rule 5310 and MSRB Rule G-18. TradeStation, its competitors, and the wholesalers to which orders are routed are already subject to a self-regulatory regime pursuant to which there has been considerable and robust enforcement. As an added prophylactic measure, *Regulation Best Interest* ("*Reg BI*") requires broker-dealers to manage and disclose potential conflicts of interest, like payment for order flow arrangements.[9]

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[8] *See* NASP Comment Letter dated February 28, 2023 at p. 4.

[9] TradeStation's Client Relationship Summary (Form CRS) describes the potential conflict of interest associated with receiving payment in exchange for the routing of its clients' orders.

The SEC already has the power and authority to enforce broker-dealers' best execution obligations under §17(a)(2) of the Securities Act of 1933, "[w]hich prohibits obtaining money or property in the offer or sale of securities by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." *See, e.g.*, In the Matter of KCG Americas LLC, Administrative Proceeding File No. 3-17012, December 21, 2015 ("By failing to pass on to certain customer orders more favorable available prices, Respondent breached its duty to seek to obtain best execution of customer orders, and caused its representations regarding order handling to be inaccurate with respect to those orders."); and In the Matter of Robinhood Financial, LLC, Administrative Proceeding File No. 3-20171, December 17, 2020 ("Brokerage firms cannot mislead customers about execution quality.")

Consider the progress made in retail equities and options trading since the days when traders and investors paid commissions, sometimes exorbitant ones, plus PFOF. Since 2005, Regulation NMS has driven increased transparency by improving the displaying of quotes and access to market data. These enhancements have given retail traders and investors more choices with respect to where to trade, lower-to-zero commissions, better quality executions and considerable price improvement opportunities. Now, with zero commissions and a comprehensive best execution regulatory scheme, it has never been more affordable and efficient for retail traders and investors to trade the equities markets. Since migrating to a zero-commission business model in 2019, TradeStation has seen a seven-fold increase in its retail trading volumes while delivering even tighter spreads and faster executions.

TradeStation's execution quality team works diligently to ensure that retail orders are afforded the best opportunity for price improvement. Monthly, a working group reviews execution quality analytics and collaborates on how to reallocate equities and options order flow based on execution quality and related factors. The working group also routinely considers adding competing venues, including the national exchanges, provided they can deliver high quality executions for our clients' orders. This deliberative and PFOF-neutral approach to best execution has proven effective, affording considerable benefits to TradeStation's retail and institutional clients. Many TradeStation competitors follow similar order routing regimens which have delivered superior execution quality industry wide.[10]

TradeStation has, and always will be, supportive of reasonable regulation to protect and inform retail investors and traders, and believes that Regulation NMS, as currently deployed, and FINRA's Best Execution Rule (5310) and MSRB Rule G-18, when combined with *Reg BI*, present a regulatory scheme that effectively manages potential conflicts of interests related to PFOF.

D. Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders

a. Minimum Pricing Increments

TradeStation believes that a migration towards smaller tick sizes, from the current minimum pricing increment of $0.01 in order to tighten spreads for some tick-constrained symbols makes

[10] Every broker-dealer displays the material aspects of their order routing arrangements on their Rule 606 Reports which are updated quarterly.

sense, but believes that the Commission's suggested variable minimum pricing increment for quotations and orders for all NMS stocks as small as $0.001 goes well beyond what is necessary, and would also be cost prohibitive and complicated to implement. TradeStation believes that tightening spreads with a minimum tick size of $0.005 for tick-constrained symbols would achieve the Commission's objective, so we adopt the consensus position presented by NYSE Group, Inc., Charles Schwab & Co., and Citadel Securities in the *"Minimum Pricing Increments, Access Fees, and Round Lots"* section of their March 6, 2023 Comment Letter, a position which happens to be shared by some of the national exchanges including MEMX, LLC, Cboe Exchange, Inc. and the Nasdaq Stock Market.[11]

TradeStation is concerned that the proposed amendments to Rule 612 will reduce competition and liquidity, making it more difficult for wholesalers to offer price improvement to retail traders and investors. In addition, proposed Rule 612 would allow more sophisticated market participants, like institutional traders, to gain execution priority over competing limit orders by stepping ahead of retail orders by an economically insignificant amount. Moreover, by aligning tick size to trade size, the proposed amendments would unduly penalize retail traders solely for the benefit of the national exchanges and large institutional traders because wholesalers would no longer be able to give retail trades sub-price increment price improvement.

The Commission also fails to adequately address the prohibitive costs that will be borne by the industry if Rule 612 is adopted as proposed and fails to consider how those costs will disproportionally impact smaller market participants, like TradeStation. The proposed changes would require broker-dealers to revamp technology to manage the dramatic increase in market data that would have to be ingested and displayed. The technological changes would no doubt increase the likelihood of technology-related issues and disruptions and lessen the ability of wholesalers to intervene and manage technical issues to the clients' benefit, something we believe wholesalers do far better than the national exchanges. Moreover, as more symbols become tick-constrained quarter-over-quarter, broker-dealers will have to manage extensive symbol changes which will no doubt impact clients' resting GTC orders, resulting in more operational customer complaints.

b. Minimum Trade Increments

TradeStation opposes any rule that would force harmonization of tick and trade increments. Trade increments smaller than the quote have proven valuable for wholesalers to deliver price improvement to retail traders and investors. The alignment of tick and trade increments would only serve to increase the national exchanges' market share to the detriment of retail traders and investors. If passed as drafted, Rule 612 would negatively impact execution quality.

E. Disclosure of Order Execution Information

TradeStation believes that full disclosure of order data and the cost-to-trade are important to allow retail traders and investors to factor the costs of trading into their trading or investment decisions. Even though TradeStation believes that the current execution quality reports deliver sufficient comparative information on execution quality, we support reasonable revisions to the

[11] Exchange Act Release No. 96494 at pp. 45-50.

disclosure requirements, provided the data required to generate the information is both readily available and will materially aid traders and investors with their decision making.

Finally, the Commission should recognize and account for retail client personas that vary considerably among broker-dealers. These differences cause execution quality data to be difficult to compare on an apples-to apples basis because, for example, trade and execution data generated from buy-and-hold investors' orders differs vastly from the same data generated from active traders' orders.[12]

F. Conclusion

TradeStation supports reasonable regulation designed to enhance execution quality for its retail clients' orders, but believes that the Proposals are cumbersome, conflicting, costly and will reduce competition and transparency. Should the Commission go forward with the Proposals, TradeStation believes that they should be adopted incrementally, starting first with changes to the *Order Disclosure Rule*, followed by the Regulation NMS tick size changes, subject to the modifications proposed in this letter.

TradeStation believes that the other two proposed rules, the *Order Competition Rule* and *Regulation Best Execution*, should not be adopted by the Commission for the reasons stated above, and suggests that those proposals be tabled at least until after a reasonable period of time has passed to allow the Commission and the industry to evaluate the improvements, effectiveness and other metrics associated with changes to the *Order Disclosure Rule* and Regulation NMS.

Respectfully submitted,

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[12] The Commission recognizes that certain retail firms have a higher percentage of orders with adverse selection where institutions have more information than retail traders.