



March 31, 2023

*VIA ELECTRONIC SUBMISSION*

Vanessa A. Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-0190

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:

Apex Fintech Solutions Inc. (together with its subsidiaries, "**Apex**")<sup>1</sup> appreciates the opportunity to comment on the Securities and Exchange Commission's (the "**Commission's**") December 2022 package of market structure proposals. As the parent company of leading broker-dealers that handle retail customer order flow (Apex Clearing Corporation, or "**ACC**") and operate order-by-order competitive auctions (CODA Markets, Inc., or "**CODA**"), Apex is particularly focused on retail equity market structure and how it would be impacted by the Commission's package of proposed rules.

This letter comments primarily on the Proposed Rule 615 (the "**Order Competition Rule**"),<sup>2</sup> though it also contains commentary on the Commission's simultaneous proposals regarding Regulation NMS ("**Tick Size Rule**"),<sup>3</sup> Regulation Best Execution ("**Reg Best Ex**"),<sup>4</sup> and Rule 605<sup>5</sup> (together, the "**proposed rule set**"), as well as the relationship between the four proposals.

Apex has a great interest in promoting order-by-order competition, a trading mechanism long advocated by Apex and CODA its alternative trading system ("**ATS**") subsidiary. In fact, as the Commission is aware, in April 2022, Apex requested exemptive relief from the Commission to facilitate a proposal for CODA to offer a retail equity order auction mechanism (the "**Apex RAM Proposal**").<sup>6</sup> Apex believes that the Apex RAM

<sup>1</sup> Apex is a leading provider of digital trading infrastructure. Through its subsidiaries, and among other things, Apex provides other financial technology firms with access to back-end financial market infrastructure that facilitates those firms' retail customer-facing business. In particular, Apex Clearing Corporation is one of the largest clearing brokers servicing retail introducing broker-dealers and investment advisers, and, as of January 2023, had over \$100 billion in customer assets under custody. As a clearing broker, ACC provides its clients with order routing and execution services, and is very familiar with retail equity market structure and mechanisms for achieving best execution for its retail customer orders. Apex's subsidiary CODA Markets, Inc. is a registered broker-dealer and operates a registered alternative trading system that features on-demand auctions.

<sup>2</sup> Exchange Act Release No. 96495 (Dec. 14, 2022) (Order Competition Rule) at 387-8 ("**Order Competition Rule Release**").

<sup>3</sup> Exchange Act Release No. 96494 (Dec. 14, 2022) (Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders) ("**Tick Size Rule Release**").

<sup>4</sup> Exchange Act Release No. 35-96496 (Dec. 14, 2022) (Regulation Best Execution) ("**Reg Best Ex Release**").

<sup>5</sup> Exchange Act Release No. 35-96493 (Dec. 14, 2022) (Disclosure of Order Execution Information) ("**Rule 605 Release**").

<sup>6</sup> A copy of Apex's request for exemptive relief, dated April 8, 2022, is attached as Annex A. As described in the request, Apex sought an exemption from Rule 612 of Regulation NMS to permit it to operate a retail auction mechanism that could accept and rank auction responses that could result in price increments of less than \$0.01. Apex's request for exemptive relief was initially submitted with a request for confidential treatment, although Apex has informed the Commission that it has withdrawn the confidentiality request, in order to allow the Commission to publicly consider the Apex RAM Proposal in connection with the proposed Order Competition Rule.

Proposal would achieve the benefits that the Commission is seeking to achieve through the proposed Order Competition Rule, without many of the risks and drawbacks that we describe below.

In particular, Apex is concerned that the proposed Order Competition Rule is overly prescriptive and dictates a recipe for trading that is far too specific and rigid. The proposal would therefore be inconsistent with the SEC's mandate to promote competition amongst venues,<sup>7</sup> and, by locking in a market structure that the Commission believes makes sense in 2023, would inhibit innovation potential as the market and technology continue to progress. Further, the potential benefits of the rule that the Commission points to, even if accurate, are dwarfed by the risks and costs imposed by the known and possible unknown side effects.

**I. As proposed, the Order Competition Rule is anti-competitive.**

Apex believes that a well-functioning system for order-by-order competition should preserve and encourage competition on multiple dimensions. But as proposed, the Order Competition Rule would restrict competition in multiple ways, with implications beyond the individual orders that would be routed through the Commission's new proposed structure. Ironically, the proposed Order Competition Rule would, while extolling the virtues of competition between *orders*, prevent competition between *markets*.

**A. The proposed Order Competition Rule unnecessarily restricts competition among types of venues.**

Currently, a retail order can be executed on multiple venues, including on an exchange, on an ATS, through a market maker, or through internalization via the broker's own inventory. There are multiple providers of each external venue of execution, and brokers are bound by the existing duty of best execution to seek the best of these multiple options for execution of the order. The availability of multiple venues for execution and multiple providers for each type of venue creates competition amongst the providers of these venues, incentivizing them to provide high-quality service offerings that are often tailored to their particular target market segments.

These competitive pressures have helped drive many of the market improvements over the last several decades, resulting in multiple high-quality execution venues for different order types, rather than a one-size-fits-all approach. These competitive forces should be preserved and strengthened in creating venues for order-by-order competition. The Commission should allow multiple markets, including new entrants, to compete to operate auctions, allowing market forces to select the best-performing venues.

Under the proposed Order Competition Rule, to operate a qualified auction, a market must be an "open competition trading center." But the Commission has proposed defining that term in a manner that forecloses meaningful competition by restricting the entities that can operate qualified auctions to a handful of the largest, already-existing exchanges.

Under the proposed rule, an open competition trading center would need to meet various criteria that primarily describe large national securities exchanges and exclude ATSS. Among other things, the criteria include that (i) the trading venue have had an average daily share volume of one percent or more of the aggregate average daily share volume for NMS stocks during at least four of the preceding six calendar

<sup>7</sup> In addition to the general Securities Exchange Act of 1934 ("Exchange Act") requirement that the Commission "not adopt any such rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange Act]," (Exchange Act § 23(a)(2)), the Commission has repeatedly concluded that rules or actions promoting competition amongst venues is in line with its mandate to promote "fair competition". See, e.g., Exchange Act Release No. 40760 (Dec. 8, 1998) ("**Reg ATS Adopting Release**").

months, and (ii) for ATSS, (A) that the ATS display quotations through an SRO display-only facility, and (B) that the ATS comply with “equal access” requirements.

These requirements are unnecessarily onerous, so much so that only a handful of the current market participants could meet them. In fact, if the Order Competition Rule had become effective when it was proposed, only national securities exchanges would have been eligible to operate qualified auctions. Not a single ATS would have been eligible to compete, because no ATS displayed quotations through a self-regulatory organization display-only facility, and few (if any) might have met the average daily share volume threshold.

Even if a currently-operating ATS were to meet the 1% average daily share volume threshold, that ATS would have to make significant changes to its operations in order to meet the Commission’s requirements for an open competition trading center. Among other considerations, the ATS would have to make elements of its business more exchange-like (without the benefits of SRO immunity or limitation of liability rules) and, in some instances, conforming to standards that are even more stringent than those applied to exchanges.<sup>8</sup>

And yet, the Commission does not acknowledge that the proposed rule would effectively prevent ATSS from operating qualified auctions. Rather, the Commission estimates that approximately three ATSS would “make the business model modifications necessary”<sup>9</sup> to become open competition trading centers. But achieving eligibility would not simply require “business model modifications.” It is instead quite possible that *no* ATSS would be able to qualify as an open competition trading center. Rather than mere modifications, as demanded by the Commission, such ATSS would need to operate an entirely *different* business model than the one that they have found to be competitive today. This is particularly true for ATSS that serve a more niche portion of the market for NMS stocks or otherwise tailor their offerings to nontypical orders. Further, an ATS cannot simply “modify” its business to reach the requisite share of market volume. Increasing market share requires *competing*. Yet the proposed rule creates a Catch-22: an ATS cannot compete to operate qualified auctions unless it has 1% of volume. But the proposal itself would make reaching 1% of volume more difficult, as almost all segmented orders are likely to be routed to qualified auctions and unavailable to such an ATS.

A rule that allows for competition only among market participants that already have a significant market share is anti-competitive on its face.<sup>10</sup> It would enshrine in regulation a prohibition on new entrants, protecting incumbents forever from any would-be competitors. This is clearly inconsistent with the SEC’s mandate to “promote ... competition”<sup>11</sup> and Congress’s objective to “assure ... fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets.”<sup>12</sup> In fact, the Commission has previously cited this objective as the basis for facilitating competition in the national market system between ATSS and national securities exchanges.<sup>13</sup>

The proposed rule effectively mandates that qualified auctions can occur only on one type of venue —major existing exchanges—but not ATSS. But the securities market has benefitted from the competition, as the

<sup>8</sup> For instance, the ATS would have to provide “equal access” among subscribers to any continuous order book operated by the ATS. The Commission notes that this standard for fair access is even more stringent than the “no unfair discrimination” standard that applies to exchanges. See Order Competition Rule Release, *supra* note 2, at 96.

<sup>9</sup> *Id.* at 150.

<sup>10</sup> It is a basic tenet of antitrust law that government regulation favoring incumbents can create price advantages for incumbents or other anticompetitive barriers to entry. See, e.g., Areeda and Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* (CCH) 421.

<sup>11</sup> Exchange Act of 1934 § 3(f).

<sup>12</sup> Exchange Act § 11A(a)(1)(C).

<sup>13</sup> See, e.g., Exchange Act Release No. 51808 (Jun. 9, 2005) (Regulation NMS) at 12; Reg ATS Adopting Release, *supra* note 7.

Commission itself has repeatedly recognized. In adopting amendments to Regulation ATS, the Commission noted that ATSS, for instance, provide liquidity into the market for NMS stocks,<sup>14</sup> host markets for stocks that are less frequently exchange-traded, creating a more flexible market<sup>15</sup> and helping decrease trading costs, potentially through supporting increased market fragmentation and competition.<sup>16</sup>

Further, as a fact of modern life—no matter how well designed, implemented and tested—sometimes technological errors occur. Exchanges and broker-dealers (including ATSS) compete on this basis as well. As a matter of market structure and regulation however, when technology breaks for exchanges, the requirements for exchanges to have and abide by their own rules makes them less nimble and able to react quickly, or cover market losses that they caused.<sup>17</sup> Meanwhile, broker-dealers and ATSS are able to react and, where appropriate, resolve errors and losses in a fair, equitable, and timely way. Allowing multiple markets that are subject to different structures allows market participants to choose their preferred model, and venues to compete for them.

Preemptively restricting qualified auctions to a single type of venue before these auctions can even begin to occur on the scale envisioned by the Commission in the proposed rule is, at a minimum, inadequately explained, and is likely an unnecessary and detrimental restraint on competition, preventing market forces from selecting the best possible venue—or venues—for order-by-order competition.

B. The proposed rule unnecessarily restricts competition as to *auction market design*.

As with auction venues, the proposed rule predefines auction market design to essentially a single format. Rather than laying out a principles-based structure for how auction markets for segmented orders should operate, the proposed rule mandates, in strikingly granular detail, exactly how qualified auctions must operate—prescribing auction parameters so narrowly as to leave auction providers with little to no room to differentiate, innovate or compete amongst offerings. For example, the Commission has specified:

- Auction message announcement process;
- Data elements to be included in auction announcements and responses;
- Minimum and maximum auction length;
- Pricing increments;
- Fees and rebates;
- Integration of continuous order book; and

<sup>14</sup> Exchange Act Release No. 83663 (Jul. 18, 2018) (Regulation of NMS Stock Alternative Trading Systems) at 15-16.

<sup>15</sup> *Id.* at 441.

<sup>16</sup> *Id.* at 450.

<sup>17</sup> Market participants suffered tens or hundreds of millions of dollars of losses from an exchange's technology failures associated with the highly anticipated initial public offering of Facebook. See, e.g., Maria Bartiromo and Javier E. David, "UBS to Take \$356 Million Loss on Facebook IPO," *CNBC* (Jul. 31, 2012) <https://www.cnbc.com/id/48427456>. The exchange's compensation plan covered only a tiny share of these losses. See Exchange Act Release No. 34-69216 (Mar. 22, 2013) (Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Granting Approval of a Proposed Rule Change to Amend Rule 4626—Limitation of Liability) (Commission order permitting Nasdaq to provide an exemption from its rules limiting liability, allowing it to provide one-time compensation relating to its system failures during the initial public offering of Facebook—ten months following those losses being incurred).

- Both mandated and prohibited order priority rules.

While claiming to provide open competition trading centers with “flexibility” on other aspects of their systems, the result of the Commission’s mandated design requirements is that qualified auctions would have little basis for differentiation and competition. The narrow parameters leave almost no room for differentiation between auction offerings.

Not only does the proposed rule cement a rigid structure prohibiting future competitive adjustments once if Proposed Rule 615 were to become effective, it does not reflect actual competitive results in the existing market. The auction design parameters defined in the Commission’s proposed rule are not market-tested, and the proposed rule’s mandates are based solely on the Commission’s theories about how the market *might* operate, in comparison to the *current* market. Worse, the proposed rule set would set in stone, for an indefinite period of time, a structure mandating specifically how qualified auctions must be conducted. The rules would not permit market participants to seek to offer a better service, taking into consideration future innovations, market developments, and continued advancements in technology.<sup>18</sup>

C. The Commission should permit the market to decide rather than preemptively restrict venues and auction design.

The Commission should not restrict which regulated venues may operate auctions, nor mandate precisely the manner in which those auctions operate. In a competitive market, different firms will have different ideas, each competing to provide the best service to clients at the lowest cost. Brokers compete with one another to better serve their customers, and in fact have an existing regulatory obligation to seek best execution of those customer orders.<sup>19</sup>

Ironically, on the same day as proposing the Order Competition Rule—mandating precisely how all segmented orders must be handled and routed, which markets may operate qualifying auctions, and how those auctions must operate—the Commission also proposed new Reg Best Ex, which should obviate the need for many of the requirements in the Order Competition Rule. According to the Commission, Reg Best Ex would “enhance the existing regulatory framework”<sup>20</sup> around best execution, by requiring broker-dealers to engage in ongoing extensive efforts and analysis “to ascertain the best market”<sup>21</sup> for a customer transaction. Under existing best execution obligations, and certainly if Reg Best Ex enhances that duty, broker-dealers would be required to route customer orders, and certainly segmented orders, to the best market for that order—ensuring that various auction markets would need to compete.

If the Commission permitted both exchanges and ATSS (regardless of other criteria), to operate auctions for segmented orders in a manner that they design (rather than in the precise manner prescribed by the Commission), best execution and competition would drive customer orders to the market that a broker-dealer determines is appropriate *for that particular order*. Rather than being required to route all orders to one of only a few, essentially identical, auction structures—regardless of the parameters of the order—brokers could select amongst multiple venues and multiple auction structures the most appropriate

<sup>18</sup> Indeed, in separately proposing amendments to Rule 610, the Commission itself recognized the risk of a market being locked into the assumptions that were made at the time when rules were adopted. See Tick Size Rule Release *supra* note 3, at 96 (“In the intervening seventeen years since rule 610 was adopted, the markets have evolved dramatically. Market innovations and technological efficiencies have reduced transaction and trading costs (e.g., lower commissions and more narrow bid/ask spreads) in the equities markets.”).

<sup>19</sup> See FINRA Rule 5310 (Best Execution and Interpositioning).

<sup>20</sup> Reg Best Ex Release, *supra* note 4, at 1.

<sup>21</sup> *Id.* at 10.

forum for execution of a particular order. Even better, market design would not be indefinitely locked-in, as markets could continue to innovate and compete, and broker would continuously redirect their customer orders to the best-performing venues.

The Commission might argue that, if market competition and best execution were in fact sufficient, order-by-order competitive auctions would already exist. But as the Commission is aware, it has not been a lack of interest, but rather other Commission rules, that have prevented these markets from developing. As discussed below, Apex itself designed and proposed an order-by-order retail auction market, but has been unable to launch it while awaiting exemptive relief from the Commission.

## II. The Apex RAM Proposal

Reacting to the Chair's prior calls for greater order-by-order competition,<sup>22</sup> Apex introduced a proposal for an order-by-order retail auction market (called "**RAM**") to the staff and chair of the Commission, on a confidential basis, more than a year before the Commission proposed the Order Competition Rule. In order to proceed with RAM, Apex determined that exemptive relief from Rule 612 would be necessary, so that RAM could accept and rank orders that could compute to sub-penny increments. Following extensive discussions with the Commission staff and providing confidential drafts, in April 2022, Apex formally submitted its request for exemptive relief from Rule 612 in order to operate RAM.

The Apex RAM Proposal is detailed in full in Apex's exemptive request, a copy of which is attached as Annex A to this comment letter. For purposes of providing context for our comments on the Order Competition Rule, we summarize the Apex RAM Proposal below.

RAM is designed as an ATS to bring together orders of retail brokers, market makers and institutional brokers. Each party would be able to select those counterparties that it is willing to trade with. Non-retail orders (e.g., from an institutional broker) could either rest as limit orders on RAM, or be submitted as a real-time auction response. Auctions on RAM would be triggered by retail orders. Upon receipt, retail brokers could route retail customer marketable orders to RAM, and then RAM would alert eligible auction participants of the symbol and size (but *not* the side) of the auction. Respondents would provide an indication of the level of price improvement that they would be willing to provide, as compared to the NBBO. Auctions would last one millisecond by default, although retail brokers could customize the length of auctions that they initiate.

At the end of the auction, RAM would compare the auction responses and any orders resting on its book and then determine which indication or order offered the most price improvement to the retail customer. If the winner is an institutional broker with a resting order, RAM would execute the trade as an ATS. If the winner is a wholesale market maker (itself a trading center under Regulation NMS), RAM would route the order to that market maker to execute the trade.

RAM would track auction execution information and then make extensive data regarding execution quality available to RAM participants. This would allow participants to regularly evaluate the performance of their counterparties against other market participants, through anonymized, aggregated data as appropriate, and revise their counterparty list accordingly. This data would aid retail brokers in regularly reconsidering their counterparty lists and whether to add new eligible auction participants.

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<sup>22</sup> See, e.g., Chair Gary Gensler, SEC, "Prepared Remarks at the Global Exchange and FinTech Conference," (Jun. 9, 2021) *available at* <https://www.sec.gov/news/speech/gensler-global-exchange-fintech-2021-06-09>; Chair Gary Gensler, SEC, "Testimony Before the United States House of Representatives Committee on Financial Services," (Oct. 5, 2021) <https://www.sec.gov/news/testimony/gensler-2021-10-05>.



Apex has been waiting for the Commission to respond to its request for exemptive relief for almost a year. In order to begin to bring order-by-order competition to the market, CODA filed a Form ATS-N for RAM in June 2022.<sup>23</sup> As Apex has not yet received relief from Rule 612 for RAM, under the Form ATS-N as filed, RAM would only be able to operate at full penny increments (and midpoint), thus limiting the benefit of price improvement and competition that RAM would otherwise bring to the market.

The Apex RAM Proposal was developed by taking into consideration extensive market research and experience. Nonetheless, under the proposed Order Competition Rule, the Apex RAM Proposal would likely be prohibited because (i) the broker-dealer operator of RAM, CODA, would not have the requisite pre-existing market share, and (ii) Apex has made different market design choices than the Commission, and the Commission has proposed to only permit one market design. Yet, the Apex RAM Proposal would solve many of the same issues the Commission seeks to resolve (e.g., order-by-order competition, institutional access to retail order flow), while avoiding many of the challenges presented by the proposed Order Competition Rule, described below.

### III. Many design elements of the proposed rule should be reconsidered.

If notwithstanding the comments above, if the Commission insists on mandating the particular design features of qualified actions, it should reconsider various elements of its proposal.

#### A. The Commission should allow for a broader range of auction durations, particularly shorter durations.

Apex believes the Commission's proposed auction length is too long for most stocks and is likely to encourage the type of gaming behavior the Commission seeks to prevent. The proposed rule would mandate an auction length of between 100 and 300 milliseconds. While the Commission suggested that this timeframe would allow market participants with a variety of technological capabilities to participate,<sup>24</sup> in Apex's experience, the type of market participant that would respond in real-time to auctions typically already have the technology to handle much shorter durations, and this capability is likely to increase over time. While the Commission's proposed auction duration may allow a few more participants into an auction, it would do so at the expense of auction quality. In the current market environment with exceedingly fast participants, 100 milliseconds (let alone 300 milliseconds) is considered an "eternity" for trading in many securities and is likely to encourage gaming behavior among players with faster connections.<sup>25</sup> These market participants would be able to adjust their bids over the course of the auction, perhaps many times, as continuous market developments occur. An auction of this length also risks that market participants, receiving advance information about an upcoming order, could trade ahead of the auction—ensuring that the retail customer receives a *worse* price.

Apex is speaking from experience. Apex's CODA subsidiary began operating auctions defaulting to 20 milliseconds in 2009, and moved with the market to reduce that default to one millisecond in 2021. Apex and CODA have found that one millisecond is long enough to receive sufficient auction participation, while short enough to discourage gaming behavior of the type described above. Apex understands that under

<sup>23</sup> The Commission has not yet completed its review of Apex's Form ATS-N for RAM. Apex has since consented to extending the Commission's time to act on the Form ATS-N until May 13, 2023.

<sup>24</sup> See Order Competition Rule Release, *supra* note 2, at 111.

<sup>25</sup> Indeed, the 350 microsecond "speed bump" used by Investors' Exchange LLC, which raised significant controversy when proposed to be used on a national securities exchange, is *285 times* shorter than even the Commission's shortest 100 millisecond auction delay. See In the Matter of the Application of Investors' Exchange, LLC for Registration as a National Securities Exchange, Exchange Act Release No. 78101 (June 17, 2016). If a 350 microsecond delay is sufficient to counter latency arbitrage, a delay almost 300 times longer seems like it would invite it.

some conditions and for some auctions, a broker may prefer a longer auction duration, as the potential additional participants would be of greater value to execution than the potential harm caused by gaming behavior. Rather than being required to adhere to a single, Commission-mandated auction mechanism for all participants and all stocks, auction operators should be able to try different approaches, and market participants can determine which provides best execution. Allowing auction providers to retain the ability to customize auction duration could allow for a more appropriate auction for a particular order.

In contrast to the proposed Order Competition Rule, the Apex RAM Proposal allows for auction-level customization. By default, auctions would last one millisecond, but retail brokers would have the flexibility to determine their preferred auction length based on their analysis of the market for that security. Rather than mandating a specific permanent set design in advance, as the Order Competition Rule would, the Apex RAM Proposal would allow retail brokers to try various auction lengths for different securities or order types, and adjust as necessary based on their best execution analysis.

B. The Commission should not require the disclosure of an auction message.

Apex believes that the Commission's proposed auction message requirements, in particular, the requirement that an auction message be announced to eligible qualified auction participants, which is a (by order) segmented order seek to go to trade<sup>26</sup>—will also encourage gaming behavior detrimental to auction quality.

It is neither necessary nor beneficial for an auction message to be disclosed to all participants, with the potential for auction participants to disclose the information to others. Particular to the potential for auction participants to disclose the information to others is the 0 millisecond requirement to disclose the order to all participants, which is unnecessary information leakage that market participants trading ahead of the auction finalization, with the knowledge that the order is not yet in order.

In contrast, the proposed Order Competition Rule, the Apex RAM Proposal would not require an auction initiating message to disclose to all participants the order details, thus avoiding information leakage or potential control by participants.

The Commission should lower the \$ 10,000 threshold for large order exempted from auction requirements.

Apex anticipates the Commission's comment that large orders may be more appropriately directed outside the regulated auction structure. However, even though the proposed rule focuses on retail investors, Apex believes that the threshold for auction exemption could be significantly lower. The proposed rule would allow orders to reach a threshold of at least \$10,000 to be exempted from the regulated auction participation requirements.<sup>27</sup>

However, even in the market area, retail orders are typically much smaller than \$100,000, which seems to be the threshold for retail orders. Apex's experience typically indicates that orders of magnitude smaller. The average retail order size for Apex' clients, which are made up primarily of retail investors, but include some institutional investors, is only \$37,000, less than half of the Commission's proposed exemption threshold. Less than 1% of Apex' customer orders exceed the \$10,000 exemption threshold. The Commission

<sup>26</sup> See Order Competition Rule Release, *supra* note 2, at 393.

<sup>27</sup> *Id.* at 396.



has already recognized that large orders may require broader liquidity access than a typical order,<sup>28</sup> but it is unclear why the Commission has chosen to set its exception threshold for broader liquidity access so high as to be almost meaningless. Rather, it appears that the Commission set the \$200,000 threshold using the threshold for a large order for NMS stocks generally, without considering the particularities of a retail order.<sup>29</sup> Particularly combined with a 300 millisecond-long auction, requiring that an order that is exceptionally large for retail be handled in the same manner as a typical—and much smaller—retail order seems insufficiently considered. Originating from a natural person client or not, an order of that size can have significant market impact, particularly if it is for a less liquid security. Announcing to the market that there is an unexecuted order of that size leaks valuable information that harms that investor.

In contrast to the proposed Order Competition Rule, the Apex RAM Proposal would not impose particular threshold-setting for large orders at all, as it would not *require* that a retail broker use RAM for any particular order. Using its judgment and subject to its best execution obligations, under the RAM model, a retail broker could evaluate the market and determine whether it believes RAM, or another venue, would be most appropriate for a particular order, given market conditions—precisely what best execution requires of broker-dealers.

D. The Commission should reconsider the auction execution priority rules.

As discussed above, the proposed Order Competition Rule would be incredibly prescriptive in how qualified auctions set their priority rules, and then couple those requirements with “anti-gaming” rules to avoid having the mandated priority rules worked around. Apex believes that attempts to so closely dictate the operation of the market, and then predict and prevent how market participants may seek to game those dictates, cannot possibly consider all situations and will have unintended consequences.

For example, as currently proposed, the Commission would require that qualified auctions provide priority to displayed orders resting on the continuous order book of the open competition trading center, over same (or worse)-priced auction responses. To manage the risk of gaming that priority, the Commission then prohibits a broker-dealer with knowledge of where a segmented order is to be routed from submitting an order (for itself or another person) to the continuous order book of that open competition trading center, if that order could have priority in the qualified auction.

There may be logic in each of those proposed requirements individually. However, taken together, the result is both unworkable and self-defeating of the Commission’s goals. As proposed, no broker-dealer would be permitted to be involved in routing customer-segmented orders to a qualified auction *while also* otherwise engaging in routing its own or other customers’ orders to the continuous order book of the open competition trading center. As a result, broker-dealers would be prohibited from engaging in both market making and order routing business. In effect, every time a broker-dealer routed a customer order to a qualified auction, it would need to stop engaging in market making on the related continuous order book—since its market maker quotes *could* have priority (depending on the auction responses). Similarly, the broker-dealer could not route customer A’s order to a continuous order book, if the broker-dealer had previously routed customer B’s segmented order to the related qualified auction. The realistic result is that firms won’t offer segmented order routing services, since it would prohibit them from engaging in other businesses.

<sup>28</sup> See Order Competition Rule Release, *supra* note 2, at 102.

<sup>29</sup> *Id.*

This system is not workable. Even if it somehow were to be, the effect would be *less* competition for orders and likely *worse* execution—as broker-dealers would need to ensure that they used unrelated markets for the different activities, thus reducing the pool of orders that may compete in an auction. That would eliminate any benefit that the Commission envisioned there would be by requiring that qualified auctions be operated by markets with a continuous order book, and integrate that order book into the auctions.

In contrast, the Apex RAM Proposal would operate on a simpler basis: the best price wins. Rather than introducing a convoluted, market-wide system of priority, the Apex RAM Proposal would allow brokers to set their own priority rules, in line with current practice, by pre-selecting their preferred counterparties in the limited cases of ties. The retail customer would obtain the best available execution, and counterparties could compete to be preferred by the retail broker, on the basis of other benefits they provide.

E. The Commission’s requirement to segmented orders be converted into limit orders for qualified auctions is both unclear and unnecessary.

The proposed rule requires that all segmented orders be assigned a limit price when submitted to a qualified auction, but it is not clear *why* qualified auctions can only be operated with limit prices instead of market prices. Presumably, even without a limit price, Rule 611 would prevent a qualified auction from executing a trade if the best price in the auction was inferior to the national best bid or offer.

And, it is unclear how an order that a customer provided without a limit price would be assigned one. This aspect of the proposed rule provides almost no direction on how a broker should determine the specified limit price—other than by general reference to best execution. It seems to require high—potentially even unprecedented—levels of discretion by retail brokers that they were not granted by customers. If, for instance, a customer submitted an order to its broker as a *market* order, it is not clear either under the current system or in the proposed rule how a broker would have the authority to convert that order to a limit order for purposes of the auction or under what conditions (if any), an order could remain a held order. If the broker selected a limit price that required any price improvement, and the order did not receive an execution in the auction, the broker would seem to have violated its obligation to execute the marketable order as fully and promptly as possible.<sup>30</sup>

Rather than introduce this unnecessary complexity, the Commission should allow a qualified auction to use either market or limit orders—reflecting the instruction that the retail customer assigned with its order. Apex’s RAM Proposal would do just that.

F. The Commission should allow segmented orders and auction responses to be priced in increments of smaller than \$0.001.

Apex directionally agrees with the Commission’s proposals, in both the Order Competition Rule and the Tick Size Rule, to reduce the minimum pricing increment for NMS stocks and permit qualified auctions to be conducted at sub-penny prices. However, with regard to shares trading at \$1.00 or more, the proposal would limit sub-penny pricing to increments no smaller than \$0.001 (a tenth of a cent). This unnecessarily constrains the level of price improvement that retail investors could obtain.

As the Commission itself acknowledges, sub-penny executions are generally beneficial to retail investors,<sup>31</sup>

<sup>30</sup> See FINRA Rule 5130 supp. mat. .01 (requiring that a FINRA member “make every effort to execute a marketable customer order that it receives fully and promptly).

<sup>31</sup> Tick Size Rule Release, *supra* note 3, at 24.

and, in the time since Rule 612 was adopted, market participants have developed the technology to handle the expected message traffic associated with orders with smaller minimum pricing increments.<sup>32</sup> As Apex previously explained in its exemptive relief request, there is no real reason to restrict the increments at which orders can be accepted into blind auctions. Because the orders are not displayed, there is no risk of “stepping ahead.” Artificially imposing a \$0.001 minimum increment only imposes an artificial limit on the level of price improvement that an order-level auction may otherwise produce.

The Commission’s proposal to limit the minimum increment is especially odd given that the entire benefit of the Order Competition Rule, the Commission claims, is to eliminate a “competitive shortfall” of only 1.08 cents per \$100 traded (or \$0.000108 per dollar).<sup>33</sup> Even assuming that this competitive shortfall figure is accurate, or that the proposed rule would address it, it shows the Commission is very much focused on the potential that sub-penny price improvement is not being fully realized. Why then, is it sensible for the Commission to at the same time reduce the opportunity for retail investors to receive sub-penny price improvement by artificially limiting the pricing increments to tenths of a penny?

**IV. The Commission’s cost-benefit analysis underestimates the likelihood of significantly increasing costs, burdens, and risks on retail investors, for the benefit of de minimis savings.**

As mentioned above, the Commission estimates that the “competitive shortfall” that retail investors would save, if the proposed Order Competition Rule is adopted, to be approximately 1.08 basis points per dollar traded, or slightly over \$0.0001 per dollar of volume. Even assuming that this is an accurate estimate of the benefits, it is vanishingly small. While this may add up to \$1.5 billion annually across the entirety of the market, per the Commission’s calculations, on a percentage basis, it is hardly a rounding error of the nearly \$143.8 trillion in annual NMS equity market volume.<sup>34</sup> In fact, the Commission estimates that the benefit to retail investors could be as small as 0.86 basis points. Even at 1.08 bps, on the average retail investor order size of \$3,700, the Commission’s estimate would mean the retail investor would save only about 37 cents. In fact, Apex believes any benefit from the proposed rule would likely be much smaller, if it exists at all.

**A. The proposed rule’s costs, including through lost services, would be significantly higher than the Commission estimates.**

The current market structure has provided to retail investors with significant benefits, including:

- Near-guaranteed execution, at a price that is usually better than the best displayed quotation—both for highly liquid and less liquid stocks;
- No charge from market maker to retail broker to execute an order.
  - This is true even if the market maker does not internalize the order, and the market maker itself pays a fee to another venue—this fee is typically not passed on to the retail broker. Thus, there is no charge to pass through to the retail investor;

<sup>32</sup> *Id.* at 13.

<sup>33</sup> Order Competition Rule Release, *supra* note 2, at 10.

<sup>34</sup> See Cboe US Equities, Historical Market Volume Data 2022, available at [https://www.cboe.com/us/equities/market\\_statistics/historical\\_market\\_volume/market\\_history\\_monthly\\_2022.csv-dl](https://www.cboe.com/us/equities/market_statistics/historical_market_volume/market_history_monthly_2022.csv-dl) (sum of total notional at column J).

- Potential offsetting of retail brokers' operating costs through payment for order flow (“PFOF”), supporting the elimination of retail broker commissions;
- Access for retail brokers to large number of venues, indirectly through market makers, without the operational expense of maintaining direct connections; and
- A high level of service provided by market makers to retail brokers. These service offerings include:
  - not internalizing orders the retail broker instructs the market maker not to internalize;<sup>35</sup>
  - high degree of consistent execution quality;<sup>36</sup>
  - the ability and willingness to absorb costs and losses from market-wide disruption events for the benefit of retail investors; and
  - the ability to respond quickly to market-wide disruption events,
 all without charging commissions.

These benefits are derived from the current market structure, which allows retail brokers and wholesale market makers to have a direct relationship. The proposed rule would severely restrict this direct relationship and, as described further below, regulate away the incentive structure encouraging wholesale market makers to provide their current high levels of service to retail brokers. As a result, and as the Commission itself acknowledges, retail brokers are likely to experience higher costs as a result of the proposed rule—and may pass these along to their retail investor customers.<sup>37</sup>

Access to retail brokers' order flow is a critical driver of wholesale market makers' high service levels. But under the proposed rule, retail brokers will no longer be able to provide orders directly to these wholesalers. Wholesalers who do not need to maintain a relationship with retail brokers in order to access their order flow will have no incentive to provide these benefits—and will not do so. This will increase retail broker's costs, decrease their revenues (for PFOF brokers) and eliminate various benefits that flow to retail investors. These additional costs and lost benefits certainly outweigh what the Commission anticipates to be 1.08 basis points of benefits.

The Commission further estimates that between \$1.12 – \$2.35 billion in transaction costs associated with individual investor orders will be saved by implementation of the proposed rule, as a result of increased competition to supply liquidity to these orders.<sup>38</sup> But, the Commission's analysis does not adequately account for *new* transaction costs that will be created by the loss of services in the existing market structure. For instance, the Commission claims that the proposed rule would “increase competition for market access this service is often provided for free by wholesalers. Not only would wholesalers be unlikely to provide routing services for free if the Order Competition Rule is adopted, wholesalers may be unwilling to offer this service at all—if routing orders interferes with their ability to then participate in the auction, as discussed in Section III.D, above. Rather than reducing transaction costs, the proposed rule creates new

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<sup>35</sup> Order Competition Rule Release, *supra* note 2, at 204.

<sup>36</sup> *Id.*

<sup>37</sup> Order Competition Rule Release, *supra* note 2, at 254.

<sup>38</sup> See *id.* at 182.

transaction costs for many individual investor orders. Those new costs are likely to eliminate and potentially exceed any purported benefits from a reduction in the “competitive shortfall.”

Furthermore, many retail brokers may well need to return to charging commissions if the proposed rule is adopted. Although the Commission claims it is “unlikely,”<sup>39</sup> in curtailing the incentives for PFOF, the Commission seems to leave PFOF brokers with few other viable options to continue to fund their operations. The emergence of PFOF as a revenue source for retail brokers is, in fact, what led discount brokers to eliminate commissions over the last several years. This has been a great benefit to investors, particularly the smallest investors, who can enter small trades without a trade-by-trade commission making a small investment uneconomical.

The Commission has suggested the brokers that currently receive PFOF, but likely would not if the Order Competition Rule is implemented, could restructure their business models to replace the lost revenue. For example, the Commission notes that some brokers earn advisory fees, interest income, and “account supervision fees.”<sup>40</sup> Similarly, brokers losing PFOF revenue could “increas[e] revenue from margin interest and securities lending.” One large firm, the Commission noted, would be less impacted because it has a “diversified revenue portfolio, including a large collection of proprietary mutual funds and ETFs under management and a banking unit.”

But the Commission should not be “picking winners and losers”—essentially determining by regulation that brokers that are not also providing advisory services, managing funds, operating a significant margin lending business, charging “supervision” fees, or affiliated with banks, cannot compete. By pointing to other potential sources of revenue, it seems as though the Commission believes that firms should provide execution services as a “loss leader.” That may be the case for some firms, but the Commission should not mandate a particular business model. Further, as a regulatory policy matter, it is not clear why the Commission would prefer that brokers earn revenue through advisory fees, fund management, interest income, and “account supervision fees,” rather than commissions or PFOF. Retail investors should be able to choose which services they need, and pay only for those. If these investors do not want to seek or pay for advice, account supervision, or to invest on margin, there should be a viable business model to service them. Where the fees and costs are fully disclosed—including that a retail broker accepts PFOF, the Commission should not be mandating or prohibiting its preferred or disfavored business models.

B. The Commission’s cost control efforts are unlikely to work.

At the same time as it proposes to disrupt the relationships that provide for current beneficial market incentives, the Commission believes that it can engage in rate-making to limit costs. The Commission proposes to limit qualified auctions to charge no more than five mil per share, and to pay no more than five mil per share as a rebate. The Commission estimates that, in practice, qualified auctions may be willing to pay three mil rebates to the broker-dealer that submitted the order to the auction,<sup>41</sup> and believes that the low auction fee will result in better executions.<sup>42</sup>

But price controls do not make costs disappear, they only cause them to shift, or to result in lower quality services. The Commission’s proposal will likely do both—cause brokers to reinstate commissions and add

<sup>39</sup> See *id.* at 293-5.

<sup>40</sup> See *id.* at 247.

<sup>41</sup> *Id.* at 258. The Commission separately suggests that if retail brokers received the full 5 mil rebate, it would make up for 40% of lost PFOF. Of course, auctions would not be economically viable if they were to rebate 100% of their fee. See *id.* at 294.

<sup>42</sup> *Id.* at 259.

other fees to recover lost revenue, while the benefits from the wholesale market maker model would be lost, reducing the quality of services. Indeed, an analysis by an SEC-registered Nationally Recognized Statistical Rating Organization suggests that retail brokers would need to charge between \$6 to \$7 per trade in commissions to make up for lost revenue, if PFOF were to be eliminated.<sup>43</sup> And, because commissions are charged on a per-trade basis, they would disproportionately tax smaller investors. Further, with a government-mandated fee structure, the incentive to innovate and compete is all but eliminated.

- C. The Apex RAM Proposal preserves the benefits of the current market, while improving it with an auction-based system.

Like the Commission's proposal, the Apex RAM Proposal would facilitate order-by-order competition, while allowing retail and institutional orders to have access to one another. But unlike the Commission's proposal, the Apex RAM Proposal would maintain the benefits of the current market model.

Wholesale market makers could still derive order flow benefits from their one-on-one relationships with retail brokers, thus incentivizing these market makers to continue to offer high levels of service. Retail brokers could accept PFOF, if they so choose, thus maintaining their current operational structure without having to reinstate commissions or other costs. And, the Commission's concerns about PFOF blunting competition would be mitigated—even if it paid PFOF, a wholesale market maker would still need to compete with other market makers, and institutional investors, to win an order-by-order auction.

**V. The Commission should stagger its multiple proposals and further develop the Tick Size Rule and Reg Best Ex before implementing them.**

The Commission is trying to do too much at once and is unable to accurately consider the combined effects that each proposal would have on the market, or the need for each proposal in light of the others.

Apex appreciates the Commission's efforts to modernize the trading markets. But the Commission has proposed four new or revised rules containing multiple sweeping changes simultaneously, all of which will affect the markets in as-yet-undetermined ways. Even less certain are the impacts of the proposals on each other and the resolution of areas in which they seem to conflict.

The seismic shifts in market architecture that may result from the adoption of all four proposals are not only unpredictable, but may be unnecessary—a smaller set of staggered reforms could shift the market landscape enough to allow market participants to organically develop offerings that address the Commission's goals and concerns, without a wholesale disruption of the current system. For instance, a subset of the changes would allow Apex to operate RAM and achieve the Commission's goal of order-by-order competition for retail investors. There may well be other market participants who are similarly poised to act on the Commission's other goals, with only a small shift in the regulatory and market landscape.

- A. The Commission should start by implementing its proposed updates to Rule 605, allow the market to recalibrate, and then reconsider its other proposals.

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<sup>43</sup> Bain K. Rumohr and Laura Kastner, "US Payment for Order Flow Ban May Spur Retail Commissions, Cut Volumes," *FitchWire* (Jun. 13, 2022) <https://www.fitchratings.com/research/non-bank-financial-institutions/us-payment-for-order-flow-ban-may-spur-retail-commissions-cut-volumes-13-06-2022>.



Apex agrees with other market participants that the potential cumulative impact of the proposed rule set needs to be further considered and that the Commission should take a staggered approach to implementation, starting with the proposed changes to Rule 605.<sup>44</sup>

We agree with the Commission that greater transparency in order execution data is a timely and needed improvement to the current market structure, and we therefore support the Commission's proposed updates to Rule 605. But that greater transparency itself will have a market impact, as market participants react and recalibrate their activities in response to the newly available data. This new data will also provide the Commission with greater insights into the market's functioning, providing better information for other rulemakings. Indeed, the Commission's proposal to modernize Rule 605 explains the need for these amendments on the basis of its various concerns regarding the scope, reliability and usefulness of existing Rule 605 data.<sup>45</sup> And yet, the Commission points to that same inadequate and unreliable Rule 605 data as its basis for proposing other aspects of the proposed rule set. If Rule 605 data is insufficient and unreliable, how can the Commission then rely on it to justify its other proposals?

Instead, the Commission should allow its proposed revisions to Rule 605 to go into effect and then, after a sufficient period of time, reconsider the need for and specifics of its other proposals, with the benefit of an updated, more reliable, and expanded Rule 605.

B. The Commission should simplify the Tick Size Rule and reconsider at application to execution prices.

Apex directionally agrees with the Commission's efforts to modernize tick sizes and agrees that artificial tick constraints are preventing investors from fully benefiting from potential price improvement.<sup>46</sup> However, the proposed Tick Size Rule is overly complex and reflects premature certainty about the impact it would have. As noted above, Apex believes that the Commission is trying to adjust too many aspects of market structure at once, without proper data to support its decisions or consideration of how they will interact. We agree with other commenters<sup>47</sup> that reducing the quoting increment to a half penny for tick-constrained stocks is a sensible first step. Among other reasons, most firms are already operationally capable of quoting at the midpoint of penny spreads—so reducing the tick size to half a penny would yield new data, without requiring a significant technological build. With this new data in hand, the Commission could then analyze the data that results from this change, and determine what, if any, further adjustments are necessary in view of how the market has evolved.

Further, the Commission's proposal to "harmonize" the tick size for quoting and trading conflates two entirely different issues and obscures the separate policy considerations that apply to each. A uniform tick for both quoting and trading would necessarily not be optimized for either. As the Commission has long recognized, some minimum tick is necessary for quoting, as a displayed minimum pricing increment that is too small can encourage market participants to "step ahead," while providing inconsequentially small price improvement, as well as result in "flickering" quotations.<sup>48</sup> But the Commission has also long recognized that *trading* in smaller increments does not raise these risks, and in fact, executions priced in smaller increments "due to price improvement are generally beneficial to retail investors."<sup>49</sup>

<sup>44</sup> See, e.g., NYSE, Citadel, and Charles Schwab, Letter to Vanessa A. Countryman, Secretary, SEC re: Equity Market Structure Proposals (Mar. 6, 2023), available at <https://www.sec.gov/comments/s7-32-22/s73222-20158676-326602.pdf> ("Market Consensus Letter").

<sup>45</sup> See, e.g., Rule 605 Release, *supra* note 5.

<sup>46</sup> See Tick Size Rule Release, *supra* note 3, at 11.

<sup>47</sup> Market Consensus Letter, *supra* note 44.

<sup>48</sup> Adopting Release: Regulation NMS, Exchange Act Release No. 51808 (June 9, 2005),

<sup>49</sup> *Id.*

Rather than maintaining its long-held position on the investor benefits that arise from trading increments being narrower than quoting increments, in proposing this change, the Commission cites vague fairness, competitive disparities and equal regulation considerations, while hoping that “most meaningful price improvement opportunities” would be “preserved.” As noted above with regard to the proposed minimum increment for qualified auctions,<sup>50</sup> it is quite inconsistent for the Commission to focus, with regard to the Order Competition Rule and proposed Reg Best Ex, on microscopic and purportedly forgone price improvement opportunities of \$0.000108 per dollar, but then dismiss the *certainty* that harmonizing the tick size for trading will *eliminate* price improvement opportunities, on the basis that “meaningful” price improvement might still be available. Rather, the consistency in each case seems to be the Commission reflecting a preference for on-exchange trading over execution in other venues,<sup>51</sup> without explaining *why* such execution is preferable. The effect will be to artificially increase the spreads at which orders are executed—harming investors.

Furthermore, as it does in the Order Competition Rule, the Commission seems to be unnecessarily intervening in how the market sets fees, setting overly rigid fee structures. While Apex supports the idea of tick size reform, Apex strongly encourages the Commission to reconsider and simplify the Tick Size Proposal, with further consideration of the less-disruptive alternatives proposed by market participants, before implementing a final rule.

C. Apex encourages the Commission to reconsider the necessity and design of Reg Best Ex.

Apex appreciates the SEC’s goal of establishing a more consistent and comprehensive standard of best execution, but is concerned that proposed Reg Best Ex is a solution in search of a problem. Further, as proposed, Reg Best Ex is an even less clear standard than existing rules.

As the Commission is aware, FINRA (as well as the MSRB) already impose best execution obligations on their members, and the Commission has interpreted the federal securities law antifraud rules as well as common law agency as imposing a best execution standard as well.<sup>52</sup> The Commission does not seem to have identified gaps in the current law or rules that the Commission needs to fill, but rather has taken a view that best execution is “too important” to not add an overlapping Commission-level rule as well.<sup>53</sup> But as proposed, Reg Best Ex would be just that—overlapping on substance—while creating new ambiguities about how compliance can be achieved.

For example, while much of proposed Reg Best Ex borrows from existing FINRA rules, it deviates in important but inexplicable ways. Both FINRA Rule 5310 and Reg Best Ex would require that a broker-dealer “use reasonable diligence to ascertain the best market” for a security and “buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.” Proposed Reg Best Ex, like FINRA’s rule, would require that a broker-dealer consider “markets that may be reasonably likely to provide the most favorable prices for customer orders,” which the Commission in Reg

<sup>50</sup> See *supra* ¶.F.

<sup>51</sup> See *id.* at 12-13 (noting that “the ability of OTC market makers to trade more readily in finer increments (i.e., offering sub-penny price improvement over the displayed quote) compared to the trading on exchanges and ATS has contributed to the increased percentage of executions that occur off-exchange,” before going on to summarize the proposed updates to Rule 612 and the desire to “promote fair competition and equal regulation” amongst market participants. *Id.* at 14).

<sup>52</sup> See, e.g., *In re Geman*, Exchange Act Release 43963 (Feb. 14, 2001) (“Failure to satisfy the duty of best execution can constitute fraud because a broker-dealer, in accepting an order from a customer, implicitly represents that it will execute it in a manner that maximizes the customer’s economic benefit.”), citing *Newton v. Merrill, Lynch*, 135 F.3d 266 (3d Cir 1998).

<sup>53</sup> Chair Gary Gensler, Chair, SEC, “Statement on Best Execution Proposal” (Dec. 14, 2022) <https://www.sec.gov/news/statement/gensler-best-execution-20221214>.

Best Ex calls “material potential liquidity sources.” FINRA requires that, as part of its best execution analysis, firms take into consideration conflicts of interest it may have.<sup>54</sup>

Rather than this all-things-considered principles-based approach, Reg Best Ex would impose a different calculus. While standard best execution requires consideration of “material potential liquidity sources,” if the broker-dealer has a conflict of interest involving a retail investor, for example due to payment for order flow, Reg Best Ex would impose a sort of “super best ex” obligation, requiring that firms consider “a broader range of markets.” If standard best ex requires consideration of material liquidity sources, but super best ex requires consideration of “a broader range,” then where a broker-dealer has a conflict of interest, the Commission would be mandating that it must consider *immaterial* liquidity sources. By definition, the Commission would be mandating that firms engage in efforts that it has already determined are *not likely* to provide the most favorable prices for customer orders.

1. The Commission should adopt FINRA’s introducing broker exemption rather than fashion its own.

Proposed Reg Best Ex’s treatment of “introducing brokers” is also inexplicable, and, in light of the sort of customer that Apex’s ACC subsidiary has, particularly concerning. First, the scope of the introducing broker exemption is not sensible. Second, even where the exemption applies, what is still required is impractical. And third, if the exemption does not apply, compliance with Reg Best Ex would be impossible for introducing brokers.

2. The introducing broker definition should not take compensation into account.

As the Commission acknowledged,<sup>55</sup> it is common in the market for smaller introducing brokers to have customer relationships, but not have their own ability to manage connections and order routing. So instead, they route their order flow to their clearing broker, which has “agreed to handle that order flow as agent for the [introducing broker’s] customer.”<sup>56</sup> That clearing broker, with a much broader network of markets to which it is connected, then determines where to route that order flow to obtain best execution. Since these introducing brokers are essentially rely entirely on the clearing broker’s routing services, and are not themselves able to select the ultimate routing decisions, the FINRA rule sensibly adjusts their best execution obligation to one that is possible to comply with. Recognizing their limited role, FINRA Rule 5310 allows these introducing brokers to rely on the clearing broker’s best execution analysis, so long as “the statistical results and rationale of the review are fully disclosed to the [introducing broker] and the [introducing broker] periodically reviews how the review is conducted, as well as the results of the review.”<sup>57</sup>

Reg Best Ex contains an exemption for introducing brokers, but one that really is no exemption at all and would make this introducing/clearing business model essentially unworkable. In order to be eligible for the so-called exemption, an introducing broker must meet a convoluted and irrelevant definition of “introducing broker”—which seems designed more to create another backdoor to eliminate PFOF rather than to define a term. Under the definition, to qualify as an “introducing broker,” an introducing broker must also “not

<sup>54</sup> See, e.g., FINRA Rule 5310 Supp. Mat. .09(b)(8) (mandating that firms take into account “the existence of internalization or payment for order flow arrangements”).

<sup>55</sup> Reg Best Ex Release at 143 (“Typically, a broker-dealer that does not carry customer accounts enters into an agreement with another broker-dealer that would require the initial broker-dealer to transmit all of its customer orders to the other broker-dealer for order handling and execution ... [T]he first broker-dealer is not making any decisions or exercising discretion regarding the manner in which its customer orders will be handled and executed, beyond its determination to engage the services of the second broker-dealer”).

<sup>56</sup> FINRA Rule 5310 Supp. Mat. .09(c).

<sup>57</sup> *Id.*

accept[] any monetary payment, service, property, or other benefit that results in remuneration, compensation, or consideration from the executing broker in return for the routing of the introducing broker's customer orders to the executing broker." The Commission's claim that this is intended to avoid the introducing broker having a conflict of interest in selecting its clearing broker<sup>58</sup> is off-base for several reasons. An introducing broker selects a clearing broker based on many factors, as clearing brokers provide introducing brokers and their customers a host of services. Further, the execution quality that customers receive is based on the clearing broker's routing choices—so it is *the clearing broker's* compliance with best execution that is the relevant factor to the customer's execution outcome, not whether the clearing broker has agreed to share some compensation with the introducing broker.

3. Compliance even by an exempt introducing broker would not be practical.

Even if the exemption were to be available to an introducing broker, proposed Reg Best Ex would still require that the introducing broker "regularly review the execution quality obtained from such executing broker, compare it with the execution quality it might have obtained from other executing brokers, and revise its order handling practices accordingly." While an introducing broker could monitor the execution quality received through its clearing broker and discuss any concerns it has with the clearing broker—as it does today—it cannot really evaluate what execution quality it might have received from another clearing broker. Introducing brokers are typically operationally set up to only route to their clearing brokers, they cannot test other clearing brokers to see how they "would have" performed, because they cannot shift their entire introducing/clearing relationship for a test.

Even if they could, an introducing broker "revising its order handling practices accordingly" is not practical. Almost all introducing brokers utilize their clearing brokers to route and handle their order flow. Because the clearing brokers also carry their customers' accounts, and indeed, maintain accounts directly for and in the name of the ultimate underlying customer, "revising" order handling practices may mean switching clearing firms. That is a drastic and disruptive event for all parties involved, and even typically requires consent in some form from all customers.<sup>59</sup> Operationally, customers' assets would also need to move from one clearing firm to another, raising operational risks and disruptions. Simply, even if an introducing broker qualifies for the exemption, compliance with its remaining requirements is not practical. Instead, the clearing firm—which is actually one that decides where to route the orders—should be responsible for best execution.

4. If the introducing broker exemption is not available, compliance is not possible.

While compliance by an introducing broker that qualifies for the exemption is not practical, compliance by an introducing broker that does not qualify is simply impossible. Under proposed Reg Best Ex, a firm that even the Commission generally understands to be an introducing broker,<sup>60</sup> but that would not be an "introducing broker" as defined by the proposed Reg Best Ex, would be subject to the requirements of paragraphs (a), (b) and (c) of Reg Best Ex, like any other broker-dealer. Since the Commission acknowledged that such a broker-dealer is "not making any decisions or exercising discretion regarding the manner in which its customer orders will be handled and executed"<sup>61</sup> it is simply impossible for that firm to comply with (a), (b) or (c)—it cannot "[i]ncorporat[e] material potential liquidity sources into its order handling practices, and ensure that the broker or dealer can efficiently access each such material potential

<sup>58</sup> Reg Best Ex Release at 151.

<sup>59</sup> See NASD, Use of Negative Response Letters for the Bulk Transfer of Customer Accounts, Notice to Members 02-57 (Sept. 11, 2002).

<sup>60</sup> See *supra* note 55.

<sup>61</sup> Reg Best Ex Release at 143.

liquidity source.”<sup>62</sup> It only has one liquidity source and cannot access any other material liquidity sources, let alone immaterial liquidity sources.

In light of all the above, proposed Reg Best Ex’s introducing broker provisions are impractical or impossible, unless the entire introducing broker business model changes so that the introducing brokers themselves maintain full control over routing and rely on clearing firms solely for other services. If that is what the Commission believes is necessary, it should say so—and evaluate the costs and benefits of that significant a change—rather than effectively forcing that result through Reg Best Ex. Rather, the Commission should adopt FINRA’s approach, one which has worked well and the Commission has not identified reasons to change.

## VI. Conclusion

Apex appreciates the Commission’s efforts to update the market regulatory structure. Apex is supportive of efforts to further modernize the market, but believes these must be done in a gradual, data-driven manner—by *first* implementing the Commission’s proposed amendments to Rule 605, and then considering the necessity and appropriateness of its other proposals.

With respect to order-by-order competition, Apex is highly supportive of the concept, and responding to the Chair’s initial suggestions for it, put forth a detailed, thoughtful proposal that works with the current market—rather than trying to replace it—and would allow the market, over time, to determine how best to implement auctions for the benefit of investors. Apex’s proposal would achieve many of the benefits, without the drawbacks, of the Commission’s Order Competition Rule proposal. Apex’s proposal is oriented around the incentives that drive some of the best features of the current market structure, such as wholesalers’ high service levels for retail brokers. Rather than destroying these incentives, Apex’s RAM Proposal may even strengthen them through better data and easier connection initiation, facilitating order-by-order competition and delivering price improvement to retail investors. In contrast, as described in detail above, the over-engineered and overly prescriptive proposed Order Competition Rule is seriously deficient in many respects and risks incredible market disruptions and investor harm for unproven, speculative, and even at best, minor benefits. Apex urges the Commission to withdraw its proposed Order Competition Rule, in a manner that allows for market participants to continue to compete and innovate.

Finally, even these issues aside, Apex is concerned that the Commission’s proposals in general are too prescriptive to allow for the level of competition that would let competitive forces determine the optimal market structure. The implementation of multiple overlapping and potentially confusing proposals at one time would further interfere with the market’s ability to optimize around each, likely hampering the Commission’s proposed objectives and actually *preventing* market modernization by locking in market structures that cannot continue to evolve.

Sincerely,

DocuSigned by:  
  
 F38620C7C3D5499...  
 William Capuzzi  
 Chief Executive Officer  
 Apex Fintech Solutions Inc.

Attachments

<sup>62</sup> *Id* at 41-2.

## **Annex A – Request for Exemptive Relief**





April 8, 2022

Re: Request for Exemptive Order Pursuant to Rule 612(c) of Regulation NMS  
In Connection With Proposed Retail Auction Market

Ms. Vanessa Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-0213

Dear Ms. Countryman:

Apex Fintech Solutions LLC and its subsidiaries (together, "**Apex**") respectfully request that the Securities and Exchange Commission (the "**Commission**") exercise its authority under Rule 612(c) of Regulation NMS to exempt Apex from Rule 612 of Regulation NMS ("**Rule 612**") such that a subsidiary of Apex may operate a broker-dealer and alternative trading system ("**ATS**") that will accept and rank bids, offers, orders, or indications of interest in NMS stocks in pricing increments smaller than those otherwise permitted under Rule 612, if it does so in connection with the retail order-by-order auction market (the "**Retail Auction Market**") as described herein.

Apex believes that granting an exemption from Rule 612 for the Retail Auction Market is necessary and appropriate in the public interest, and is consistent with the protection of investors, as it would (i) allow retail investors to obtain better execution pricing by increasing order-by-order competition among market makers and institutional investors to execute retail customer orders, (ii) expand institutional investors' access to retail investor order flow, and (iii) enhance the data regarding retail investor execution practices and experiences available to market participants and regulators.

### **I. Background on Apex**

Through its subsidiaries, among other things, Apex provides other financial technology firms with access to back-end financial market infrastructure that facilitates those firms' retail customer-facing business. In particular, Apex Clearing Corporation ("**ACC**") is one of the largest clearing brokers servicing retail introducing broker-dealers, and investment advisers, and as of January 2022, had more than 20 million retail customer accounts and over \$120 billion in retail customer assets under custody. As a clearing broker, ACC provides its clients with order routing and execution services, and is very familiar with retail equity market structure and mechanisms for achieving best execution for its retail customer orders.

### **II. Existing Retail Market Structure**

In general, the existing market structure for retail investor equity orders involves a customer placing an order with its retail broker (the "**Retail Broker**"), which routes for execution to a trading center, such as a national securities exchange, ATS, or a wholesale market maker (a "**WMM**"). Retail Brokers commonly

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route their customers' marketable orders (i.e., "market" or "marketable limit" orders) to one of several WMMs with which they have a routing and execution arrangement.<sup>1</sup>

Market makers generally do not seek to profit from increases or decreases in the price of the securities that they buy or sell. Rather, they seek to profit by facilitating investors' trading, buying at slightly lower prices than they sell, earning a "spread." However, market makers face the risk that the market could move against them with each trade (i.e., they buy as the market is falling, or sell as it is rising).<sup>2</sup> Market makers generally find this risk lower when trading with individual "retail" investors because their orders (i) tend to be of smaller size and are less likely to have an impact on the prevailing market price, and (ii) tend to reflect long-term investment decisions, rather than opportunistic short-term trading.<sup>3</sup> As a result, market makers find retail order flow more attractive than other order flow segments and, given the reduced risk of detrimental market movements, are willing to accept smaller spreads on retail order flow than other segments.<sup>4</sup> Some market makers operate WMM business lines that focus on retail order flow.

Because of the lower risk to WMMs, Retail Broker arrangements with WMMs typically specify certain requirements for treatment of the retail order flow routed to the WMM by the Retail Broker, as well as other undertakings by the WMM (discussed below).<sup>5</sup> These frequently include target "price improvement" metrics.<sup>6</sup> Price improvement refers to the extent to which an order is executed at a price that is more favorable to the investor than the publicly displayed prevailing national best bid or offer quotation ("NBBO") to buy or sell that security at that time. One common metric used to evaluate price improvement is called the "Effective over Quoted" or "EQ" Ratio. The EQ Ratio is calculated from a formula to indicate how the *effective* spread paid by the investor based on their actual execution price relates to the *quoted* NBBO spread.<sup>7</sup> The lower the EQ Ratio, the greater level of price improvement that the investor received. An EQ Ratio of zero indicates that the customer received an execution at the midpoint between the NBBO, effectively paying no spread, while an EQ Ratio of one indicates that the investor paid the full quoted spread reflected in the NBBO.

Retail Brokers typically will have arrangements with several WMMs, and algorithmically determine which WMM to route each customer order through what is often referred to as their "best execution wheel." The wheel may take into account the characteristics of the order or security involved, and then choose which WMM to route it to based on the WMMs' prior execution quality results for that or similar orders or securities. While the Retail Broker and WMM may have general expectations about execution quality, if the WMM to which an order is routed decides to act as the buyer or seller to the retail order (called "internalizing"), rather than routing it to another venue, the WMM has discretion to determine at what price to execute that order, subject to its own best execution and Regulation NMS obligations. Because of WMMs' best execution obligations and arrangements with Retail Brokers, that will frequently be at a price that is better than the NBBO.<sup>8</sup> To oversee their WMMs and fulfill their own best execution

<sup>1</sup> See, e.g., Staff Report on Equity and Options Market Structure Conditions in Early 2021, SEC Staff report, 11-12 (Oct. 14, 2021), available at <https://www.sec.gov/files/staff-report-equity-options-market-structure-conditions-early-2021.pdf> ("GameStop Report").

<sup>2</sup> *Id.*

<sup>3</sup> *Id.* at 12.

<sup>4</sup> *Id.*

<sup>5</sup> See *infra* Section III.b.

<sup>6</sup> *Id.*

<sup>7</sup> Mathematically, the EQ Ratio is determined by (i) first calculating the effective spread by comparing the execution price to the midpoint of the NBBO, and multiplying that number by two, (ii) calculating the quoted spread based on the difference between the national bid and offer at time, and (iii) dividing the effective spread by the quoted spread.

<sup>8</sup> GameStop Report, *supra* note 1, at 11.





obligations, Retail Brokers in turn will generally conduct regular “look-back” reviews at the execution quality that each WMM provided over a particular period of time. In addition to discussing any execution quality issues or concerns with the WMMs, Retail Brokers may adjust their “wheel” to reallocate their order flow (or order flow with particular characteristics) among their WMMs, favoring those WMMs that have been providing the superior execution quality. However, there typically is not order-by-order competition among WMMs for each individual order—this reallocation is based on a look-back, and only effects future routing decisions.

The existing retail investor market structure also has an indirect impact on the trading costs experienced by institutional investors, like pension and mutual funds. As buyers and sellers transacting to fulfill their own investment intentions (so-called “natural” buyers and sellers), retail investors and institutional investors ideally would be able to find one another at the moment that one wants to buy and the other wants to sell, without incurring transaction costs by way of market maker spreads. But because retail investor order flow tends to be segmented and routed to WMMs, institutional investors typically do not have the opportunity to transact with retail order flow (and vice versa). Institutional investors seeking execution through their brokers (“**Institutional Brokers**”) therefore incur the cost of spreads on exchanges, ATSS, or single-dealer platforms, rather than potentially crossing their orders with retail investors at a smaller or no spread.

### III. Apex Retail Auction Market Proposal

While Apex believes that the current retail market structure is incredibly beneficial to retail investors—retail investors now typically trade commission-free and at smaller spreads than any other market segment—the Commission and its Chair have noted concerns regarding retail market structure, including potential conflicts of interest, best execution, competition among WMMs, and data opacity.<sup>9</sup> Chair Gensler has specifically called for “greater competition and efficiency on an order-by-order basis” and questioned the “segmented markets and higher concentration amongst market makers.”<sup>10</sup>

#### a. Design of Retail Auction Market

Apex has designed a Retail Auction Market that it believes would address many of the Commission’s and its Chair and staff’s concerns by introducing a Retail Auction Market that would—exactly as called for by the Chair—facilitate order-by-order competition among and between market participants seeking to transact with each retail investor order. Transactions would be executed on the basis of which party is willing to transact at the best price for a specific order, ensuring that, as the Chair has called for, investors obtain the best, not just better, execution.<sup>11</sup>

<sup>9</sup> See, e.g., Testimony of Gary Gensler, Chair of the Securities and Exchange Commission, Before the United States Senate Committee on Banking, Housing, and Urban Affairs (Sept. 14, 2021), available at: <https://www.sec.gov/news/testimony/gensler-2021-09-14> (“Gensler Senate Testimony”); Testimony of Gary Gensler, Chair of the Securities and Exchange Commission, Before the United States House of Representatives Committee on Financial Services (Oct. 5, 2021) available at: <https://www.sec.gov/news/testimony/gensler-2021-10-05>; GameStop Report, *supra* note 1, at 12; Office of Compliance Inspections and Examinations and Office of Economic Analysis, U.S. Securities and Exchange Commission, *Special Study: Payment for Order Flow and Internalization in the Options Markets* (Dec. 2000), available at <https://www.sec.gov/news/studies/ordpay.htm>.

<sup>10</sup> Gensler Senate Testimony, *supra* note 9.

<sup>11</sup> See Gary Gensler, *Prepared Remarks at the Global Exchange and FinTech Conference* (Jun. 9, 2021), available at: <https://www.sec.gov/news/speech/gensler-global-exchange-fintech-2021-06-09>.





The Retail Auction Market, which would be operated by one or more registered broker-dealer subsidiaries of Apex, would consist of an ATS and a broker-dealer routing service, with three categories of participants: Retail Brokers, WMMs, and Institutional Brokers.<sup>12</sup>

Each Retail Broker, WMM, and Institutional Broker would be able to select which individual firms from the other categories it is willing to trade with. For example, Retail Brokers would continue to have arrangements with individual WMMs, and could choose only those WMMs to interact with their retail flow.<sup>13</sup>

Rather than ordinary dollar pricing, this Retail Auction Market would be based on prices reflected through "EQIs." EQIs are indications of the EQ—essentially price improvement relative to the NBBO—at which the party is willing to transact in a particular security, side, and size. The EQI is an indication of the EQ (multiplied by 100 to represent the EQ as a percentage of the bid/ask spread) at which an auction respondent is willing to provide price improvement relative to the NBBO to the auction-initiating order, if its EQI wins the auction. For example, an EQI of 50 in connection with a retail order to buy 100 shares of XYZ, where XYZ has an NBBO of \$10.00 by \$10.02, would indicate a willingness to sell 100 shares of XYZ at \$10.015 or an EQ of 0.50. The Retail Auction Market would accept EQIs up to three digits (i.e., 507, but not 5072).

Upon receipt of a market or marketable limit order,<sup>14</sup> the Retail Broker would route the order to the Retail Auction Market. Upon receipt of the order, an auction would be triggered and WMMs and Institutional Brokers would be notified of the security symbol and size and invited to submit indications that the party is willing to trade at a particular EQ for a the specific security, and at what side and size. However, the manner of responding to auctions would be structured to allow flexibility in response format such that participants could respond in the manner best suited to their business structures and workflows. Apex expects that WMMs would respond to each auction in real time, in order to avoid the intense message traffic that would be required to stream and update "resting" orders on both sides of the market for thousands of equity securities. On the other hand, Apex expects that Institutional Brokers would most commonly prefer to rest orders in advance of an auction, as they likely have specific orders that they are seeking to fill.<sup>15</sup> In any event, depending on market interest, Apex expects to offer either workflow to any participant.

Following each auction, which by default will last one millisecond,<sup>16</sup> the Retail Auction Market would compare the EQIs received or resting and determine the auction winner—the firm that responded with or rested the lowest EQI, thereby offering the greatest price improvement. If a WMM wins the auction, the Retail Auction Market would route the Retail Broker's order to that WMM, which would execute the order

<sup>12</sup> The Form ATS-N to be submitted by the Apex-subsidary broker-dealer operator of the ATS, for technical purposes, will refer to "Retail Brokers" as "Auction-Initiating Subscribers," "Institutional Brokers" as "Competitor Resting Order" providers, and WMMs as "Competing Liquidity Providers."

<sup>13</sup> As discussed further in Section III.b, while this structure would not initially create an all-to-all open market for any WMM to compete for every retail order, Apex believes that it would retain various benefits of the existing market structure and, in practice, competitive pressures and regulatory obligations would lead Retail Brokers to open auctions for their orders to a greater number of WMMs over time.

<sup>14</sup> For ease of use by Retail Brokers, Apex is additionally considering allowing the Retail Auction Market to accept non-marketable limit orders. These orders, and those that become non-marketable prior to execution, would be routed to WMMs or exchanges outside of the Retail Auction Market per the Retail Broker's instructions.

<sup>15</sup> Apex additionally anticipates that some Institutional Brokers may prefer to enter orders priced in dollars and cents rather than in EQIs. Where an Institutional Broker does so, in order to determine the auction winner, the Retail Auction Market would convert their order prices into EQIs based on the NBBO at the time of the auction.

<sup>16</sup> Retail Brokers will be able to customize the length of their auctions. Based on past experience, Apex expects that one millisecond will provide most interested participants with enough time to respond to the auction while minimizing execution time.





as principal and, pursuant to Financial Industry Regulatory Authority (“**FINRA**”) rules, report the execution to a Trade Reporting Facility (“**TRF**”) operated by **FINRA**.<sup>17</sup> If an Institutional Broker wins the auction on behalf of an institutional investor, the Apex subsidiary that operates the ATS would execute the order on the ATS and report the trade to the TRF.<sup>18</sup> In addition, to the extent that two Institutional Brokers enter resting orders that match with one another, in whole or in part, the Retail Auction Market would execute that order in its capacity as an ATS, outside of any auction, and report the trade to the TRF.

By way of example, assume that Stock XYZ has an NBBO of \$15.00 by \$15.02. Retail Broker submits its customer’s order to buy 100 shares of XYZ to the Retail Auction Market. Three WMMs and one Institutional Broker participated in the auction with the following EQIs and price offers, which would calculate to the indicated execution prices:

Auction Participant	EQI/Order	Resulting Execution Price
WMM A	90	\$15.0190
WMM B	85	\$15.0185
WMM C	73	\$15.0173
Institutional Broker D	0 (midpoint order)	\$15.01

Because Institutional Broker D rested a midpoint offer, which provided the lowest EQI when converted,<sup>19</sup> the ATS would execute a transaction where the Retail Broker (on behalf of a retail investor) buys, and Institutional Broker D (on behalf of an institutional investor) sells, at \$15.01 per share, providing the retail investor with a midpoint execution, saving both the retail customer and institutional investor the cost of paying a dealer spread. If Institutional Broker D did not participate in the auction, then WMM C would win, and the order would be routed to WMM C for execution in line with its EQI—which was the best price available among auction participants, resulting in the greatest price improvement to the retail investor.<sup>20</sup>

As a result, rather than selecting one of its WMMs to route an individual order to, and analyzing execution quality in the aggregate *ex post*, Retail Brokers would allow all of their participating WMMs, as well as institutional investors, to compete to provide a better price to their retail investor customer on a trade-by-trade basis *ex ante*, ensuring that the retail investor receives the best execution for each and every particular order. Conflicts of interest regarding Retail Brokers’ routing decisions as between their WMMs would be significantly mitigated or eliminated, as the effect of the Retail Auction Market would be

<sup>17</sup> Because an auction won by a WMM is not executed on the ATS, but is routed to the WMM for execution, it is theoretically possible that the WMM could “back away” from its EQI and execute the order at a price other than what its winning EQI should calculate to. As noted in Section III.b, Apex expects this to be uncommon, as Retail Brokers would be able to track such conduct and could react by preventing a WMM that engages in it from being eligible to interact with its future orders.

<sup>18</sup> Retail Brokers would also provide the Retail Auction Market with a counterparty priority ranking list. In the event of an auction that is tied, the tying WMM or institutional investor highest on the Retail Broker’s priority list would win the auction.

<sup>19</sup> See *supra* note 15.

<sup>20</sup> Apex expects the Retail Auction Market to charge fees and pay rebates to particular participants. While subject to change based on market conditions, at present, Apex expects to WMMs and Institutional Brokers to be charged fees, while Retail Brokers would receive rebates—consistent with common “inverted” pricing models used by some national securities exchanges and other trading venues.





to ensure that each individual retail order is executed with the party willing to provide it with the best price on that particular order. Further, the Retail Auction Market would improve execution quality and reduce costs for institutional investors, as their orders would be eligible to match with retail investors also seeking to trade with low or no bid/ask spread.

To enhance transparency and to ensure a continually evolving competitive market, the Retail Auction Market would make extensive data available to its participants. For example, each Retail Broker would receive a "report card" indicating the performance of the WMMs with which it trades, and that of other aggregated or anonymized WMMs that it does not trade with. WMMs would also be provided with data indicating the execution quality they provided as compared to anonymized other WMMs. As discussed below,<sup>21</sup> Apex expects that competitive forces and best execution obligations would pressure WMMs to continually improve their EQIs in order to continue to receive order flow, and Retail Brokers to continually evaluate whether to permit additional WMMs to interact with their order flow.

#### **b. Selection of Eligible WMMs**

As noted above,<sup>22</sup> the design of the Retail Auction Market would allow Retail Brokers to select which WMMs are eligible to participate in auctions for their customers' orders. Although Apex considered a structure that would require every Retail Broker to allow every WMM to bid on their orders, Apex determined that, for several reasons, such a structure was not optimal as an initial matter.

As described above, the current market structure for retail equity order flow typically involves Retail Brokers and WMMs entering into bilateral relationships with one another. Apex views the Retail Auction Market as enhancing, rather than replacing, those arrangements, and in practice, believes that attempts to entirely replace them may not be attractive to market participants nor beneficial to retail investors. These relationships tend to include features that are highly beneficial to Retail Brokers (and, in turn, retail investors), including relating to matters that are external to the Retail Auction Market. These include target price improvement metrics, near-guaranteed fills on marketable orders, handling of "oversize" orders (i.e., orders for a number of shares greater than available at the quoted NBBO), handling of non-marketable orders, willingness of the WMM to absorb third-party trading center execution fees for orders that are not internalized, as well as economic arrangements.

If the Retail Auction Market does not permit Retail Brokers to select which WMMs are eligible to participate in auctions for their orders, WMMs may cease providing these benefits, resulting in an overall harm to retail investors. For example, while today, many WMMs agree to seek to fill oversize orders or obtain external executions for (and absorb the cost of) those orders that they do not wish to internalize, if any WMM can participate in every auction, WMMs may no longer have the economic incentive to offer these benefits. This could result in retail orders other than smaller marketable orders obtaining worse execution than they currently do, and/or additional expenses being incurred by Retail Brokers, which may then be passed through to their customers. Further, the ability of Retail Brokers to select some WMMs and exclude others will incentivize "good behavior" by WMMs—for example, Apex expects that the risk of a Retail Broker determining that a WMM is acting improperly and deciding to exclude them

<sup>21</sup> See *infra* Section III.b.

<sup>22</sup> See *supra* text accompanying note 13.





from future auctions will greatly discourage WMMs from “backing away” from their EQIs after winning an auction<sup>23</sup> or failing to participate in auctions for orders that may be less profitable to the WMM.

In any event, Apex anticipates that the Retail Auction Market will result, over time, in Retail Brokers increasing the number of WMMs with which they interact and obtaining similar benefits from each. The Retail Auction Market will make data available from which Retail Brokers would be able to see how their WMMs are performing compared to those WMMs with which they have not selected to interact. If the Retail Broker has excluded WMMs that are providing better execution quality, competitive pressures will likely force the Retail Broker to add the additional WMMs, as Retail Brokers compete with one another on execution quality and publicly advertise their execution quality metrics.<sup>24</sup> Further, regulatory expectations for Retail Brokers to achieve best execution similarly require that Retail Brokers consider markets that the Retail Broker is not routing to, and justify decisions to exclude them.<sup>25</sup>

In fact, the Retail Auction Market will facilitate Retail Brokers adding additional WMMs in a streamlined manner that is not currently possible. One barrier to Retail Brokers adding new WMMs in the current market structure is the technological and operational build necessary to connect their systems. But the common Retail Auction Market platform would replace the need for direct connections between Retail Brokers and each separate WMM, dramatically lowering the technological and operational cost and time required to begin interacting with a new WMM. Once a Retail Broker and WMM connected to the Retail Auction Market agree to begin trading with one another, no further technology build would be needed, allowing Retail Brokers to quickly add new WMMs, as competitive and regulatory reasons arise.

Lastly, while Apex believes that the ultimate state of the Retail Auction Market will be a broadly open market where Retail Brokers permit a large number of WMMs to participate in each auction, even the more limited initial state that permits Retail Brokers to select eligible WMMs is a significant improvement over the current market. As noted above, currently, each retail order is routed to a single WMM that decides at what price to execute that order (indeed, often at a sub-penny price), consistent with its own best execution and Regulation NMS obligations. The Retail Auction Market will, for the first time, introduce order-by-order competition among multiple WMMs and institutional investors while allowing the market to evolve organically.

#### IV. Rule 612

Rule 612 of Regulation NMS provides that ATs and broker-dealers, among others, may not:

<sup>23</sup> See *supra* note 17.

<sup>24</sup> Retail Brokers regularly advertise and market their services on, among other things, metrics of the execution quality they obtain for their customers. See, e.g., TD Ameritrade, *Market Order Execution*, <https://www.tdameritrade.com/tools-and-platforms/order-execution.html>; Charles Schwab, *Schwab Order Execution Advantage*, <https://www.schwab.com/execution-quality>; E\*Trade, *Execution Quality*, <https://us.etrade.com/trade/execution-quality>; Fidelity, *Commitment to execution quality*, <https://www.fidelity.com/trading/execution-quality/overview>; *Execution Quality*, Robinhood, <https://robinhood.com/us/en/about-us/our-execution-quality>.

<sup>25</sup> See, e.g., FINRA Rule 5310.09 (“To assure that order flow is directed to markets providing the most beneficial terms for their customers’ orders, the member must compare, among other things, the quality of the executions the member is obtaining via current order routing and execution arrangements ... to the quality of the executions that the member could obtain from competing markets.”); FINRA Regulatory Notice 15-46 (Nov. 2015) (“A firm that limits its review of execution quality only to those markets to which it currently routes customer order flow without considering competing markets would not satisfy the duty of best execution.”).





display, rank, or accept from any person a bid or offer, an order, or an indication of interest in any NMS stock priced in an increment smaller than \$0.01 if that bid or offer, order, or indication of interest is priced equal to or greater than \$1.00 per share.<sup>26</sup>

As indicated in the example chart provided in Section III above, while the Retail Auction Market would accept EQIs in addition to priced orders, those EQIs would mathematically calculate to prices that, in many cases, would result in pricing increments smaller than those permitted by Rule 612. As a result, Apex is concerned that the Commission could view the Retail Auction Market as accepting or ranking orders at increments that violate Rule 612. However, Rule 612(c) permits the Commission, by order, to provide exemptions from Rule 612 if the Commission determines that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.<sup>27</sup> Apex believes that, given the broad benefits to investors and the market that the Retail Auction Market would provide, and the lack of the harms that Rule 612 is intended to prevent, an exemption is necessary and appropriate in the public interest, and is consistent with the protection of investors.

In adopting Regulation NMS, the Commission explained the purposes of Rule 612, none of which would be undermined by granting an exemption for the Retail Auction Market. Specifically, the Commission noted the following concerns, among others:

- If investors' limit orders lose priority for nominal amounts, they may cease using them, reducing displayed liquidity while undermining the price setting function of displayed limit orders.
- Widespread sub-penny quoting could reduce the number of shares available at the NBBO, thus increasing transaction costs, particularly for large orders.
- Sub-penny increments could result in "flickering" quotations that may or may not actually be accessible, creating challenges for broker-dealers to satisfy their best execution obligations.<sup>28</sup>

At the same time, the Commission noted that *trading* in sub-pennies did not raise the same concerns as *quoting* in sub-pennies, and in particular, that "sub-penny executions due to price improvement are generally beneficial to retail investors."<sup>29</sup>

Similar to other retail order execution systems that the Commission has recognized and granted exemptions to in the past,<sup>30</sup> allowing the Retail Auction Market to function with EQIs quoted in sub-penny increments would not raise the concerns that motivated Rule 612. Rather, the Retail Auction Market is more akin to trading in sub-pennies rather than quoting, and would be aimed at providing price improvement to retail investors that the Commission noted its support for. Unlike displayed sub-penny limit orders that the Commission focused on in adopting Rule 612, EQIs within the Retail Auction Market

<sup>26</sup> 17 CFR 242.612(a). For NMS stocks where the bid or offer, order, or indication of interest is priced less than \$1.00 per share, the minimum increment is \$0.0001. 17 CFR 242.612(b).

<sup>27</sup> 17 CFR 242.612(c). Apex notes that the Director of the Division of Trading and Markets has been delegated authority by the Commission to grant or deny exemptions from Rule 612 pursuant to Rule 612(c). See 17 CFR 200.30-3(a)(83).

<sup>28</sup> Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37551-52 (June 29, 2005) ("Regulation NMS Adopting Release").

<sup>29</sup> *Id.* at 37556.

<sup>30</sup> See, e.g., Cboe BYX Exchange, Inc.; Order Approving a Proposed Rule Change to Make Permanent the Exchange's Pilot Retail Price Improvement Program, Rule 11.24, Which is Set to Expire on September 30, 2019, and Order Granting Limited Exemption Pursuant to Rule 612(c) of Regulation NMS, Exchange Act No. 87154 (Sept 30, 2019); Self-Regulatory Organizations; Nasdaq BX, Inc.; Order Granting an Extension to Limited Exemption from Rule 612(c) of Regulation NMS in Connection with the Exchange's Retail Price Improvement Program Until June 30, 2018 (Dec. 1, 2017).





would have no impact on displayed liquidity, as retail investor orders internalized by WMMs are not displayed, and prices at which WMMs choose to internalize are also not displayed. Thus:

- no market participant that would otherwise have displayed a limit order would be discouraged from doing so as a result;
- there is no risk of one WMM or Institutional Broker “stepping ahead” of another by a nominal amount because EQIs are submitted in a blind, non-displayed auction; and
- there is no risk of “flickering” quotations, as EQIs are not broadly displayed, would not be disseminated through the consolidated quotation data stream and cannot be canceled or executed by a third party before the Retail Broker has an opportunity.

Indeed, rather than potentially interfering with Retail Brokers seeking best execution, the Retail Auction Market would enhance their ability to achieve it. Further, the whole purpose of the Retail Auction Market would be to provide price improvement to retail investors, a goal the Commission highlighted in adopting Rule 612.<sup>31</sup> Retail orders executed by WMMs already frequently trade at sub-penny prices, and so the Retail Auction Market would not introduce sub-penny pricing to this market, rather it would enhance the market by increasing competition and improving the execution quality that retail investors obtain. Further, the Retail Auction Market would, for the first time, enable institutional investors to compete with WMMs to transact with retail investors, as natural buyers or sellers, likely at price better than WMMs can provide. Such a market development would also further Congressional objectives enumerated in Section 11A(a)(1)(C)(v) of the Securities Exchange Act of 1934, finding that it is “in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure ... an opportunity ... for investors’ orders to be executed without the participation of a dealer.”

The competitive dynamic will be furthered by the extensive data that the Retail Auction Market will make available to market participants. Retail Brokers will be able to see how each of their WMMs is performing, how other WMMs that they do not yet connect to may be able to provide better executions to their customers, and connect to additional WMMs accordingly. WMMs will see how they are performing as compared to their competitors, and will need to consistently compete in order to avoid losing order flow.

As a result, Apex believes that an exemption from Rule 612 is necessary and appropriate in the public interest, and is consistent with the protection of investors. Apex thus respectfully requests that the Commission exercise its authority under Rule 612(c) to provide an exemptive order to allow the Retail Auction Market to function in the manner described in this letter.

Thank you in advance for your consideration of this request. If you would like to discuss the contents of this letter, please do not hesitate to contact me at [REDACTED] or Apex’s outside counsel at Davis Polk & Wardwell LLP, Zachary J. Zweihorn, at [REDACTED] and [REDACTED]

<sup>31</sup> Regulation NMS Adopting Release, *supra* note 28, at 37498, 37501.



Sincerely,

DocuSigned by:

*William Capuzzi*

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William Capuzzi

Chief Executive Officer

cc: Haoxiang Zhu, Director  
David Saltiel, Deputy Director  
David Shillman, Associate Director  
Michael Coe, Assistant Director  
Division of Trading and Markets  
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April 8, 2022

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