BMO Capital Markets

March 31, 2023

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

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

Dear Ms. Countryman:

BMO Capital Markets Corp. ("BMO CMC") welcomes the opportunity to provide comments to the Securities and Exchange Commission ("Commission") with respect to the proposed amendment to the regulation governing the National Market System ("NMS") under the Securities Act of 1934 ("Exchange Act") to update Reg NMS Minimum Pricing Increments, Access Fees, and Transparency for Better Pricing.

BMO CMC is a subsidiary of BMO Financial Corp., a U.S. financial holding company and the U.S. intermediate holding company of the Bank of Montreal, a foreign banking organization (collectively, "BMO"). BMO Financial Group is the eighth largest bank in North America by assets, with total assets of $1.14 trillion[1]. We are highly diversified, providing a broad range of personal and commercial banking, wealth management, global markets and investment banking products and services. We serve twelve million customers across Canada and the United States, and in select markets globally, through three integrated operating groups. BMO Capital Markets is committed to fair and equitable access to our equity markets. Transparency in trading and competition that allows market forces to create better and more efficient markets benefits all market participants. We commend the Commission for its detailed and progressive recommendation to create more efficient, competitive, and orderly markets.

Executive Overview

It has been over 20 years since the U.S. equity markets underwent their last major revision to quoting and trading increments, moving from fractions of a dollar to the penny increment. This move allowed for increased competition in the form of tighter bid offer spreads, reduced implicit trading costs for consumers of liquidity, and, along with Reg NMS, ushered in a new era of innovation and competition between market centers and market participants of all types. Arguably, the need to move from fractions to decimals addressed a more glaring deficiency in the late 1990s than what we face today; however, the need for targeted and incremental reform to quoting and trading increments is broadly accepted within the industry.

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[1] BMO Financial Group 2022 Annual Report to Shareholders - https://www.bmo.com/ir/archive/en/bmo_ar2022.pdf

The Commission is proposing to update the quoting and trading increments on exchange, in addition to recommending a broader package of reforms designed to address several interrelated aspects of equity market infrastructure. These reforms include harmonizing the increments for trading on and off exchange, accelerating the display of odd lot quotations on the SIP, redefining the lot sizes in US equities, reducing access fee caps, and updating how exchanges are permitted to set pricing tiers.

In summary, this package of reforms is designed to:

- Reduce trading costs in the form of tighter bid offer spreads.
- Reduce the regulatory asymmetry between prices that can be traded at on and off exchange.
- Reduce distortions and conflicts of interest created by existing access fee caps and exchange pricing tiers.
- Have the economics of a trade-after fees more accurately reflected in the execution price that is ultimately passed back to the investor.
- Reduce the round lot size in higher priced securities, which can represent a material notional value.
- Ensure that odd lot sizes at prices better than the NBBO are broadly disseminated and included in assessments of execution quality.

To increase the overall efficiency and competitiveness of the US equity market, the breadth of the proposed changes is warranted. However, with this breadth of change, outcomes are difficult to predict and additional prudence in the rollout is necessary. In particular, quoting and trading in sub pennies will make markets incrementally more complex. It will disrupt the current norms and it introduces both technological risk and strain on the systems of all market participants. Such risks should be carefully assessed against the potential benefits and, to the extent possible, mitigated with a phased rollout.

We support reducing the minimum quoting and trading increment on exchange based on time weighted average quoted spread. However, to balance risks and unintended consequences, we recommend the Commission limit quote increments to half a penny and only apply it to securities with a time weighted average quoted spread of less than $.016. After one year of implementation, if industry practitioners, academics, and regulators have evidence that an economically relevant number of securities remain tick constrained, and that there are limited negative consequences, a reasonable next step could be to implement the 20 mill increment as proposed by the Commission. Similarly, after a year with both 20 and 50 mill tick sizes the outcomes should again be evaluated and only then a decision made on further reductions to 10 mills be undertaken.

While we recommend a phased and data driven approach in reducing the quoting and trading increment, we are supportive of the concurrent implementation of accelerating the display of odd lot quotations on the SIP, redefining the lot size in US equities, reducing access fee caps, and updating how exchanges are permitted to set pricing tiers as proposed in the rule.

Modernizing the Quoting and Trading Increment

Determining specific remedies for tick constrained securities is educated guesswork. We have limited data to rely on – our primary sources are from stock splits and the Commission's 2016-2018 tick size pilot in small cap equities. We can poll the brightest minds in our industry and draw upon the data we have, but we cannot know a priori what the outcome of complicated and interconnected changes will be. We acknowledge there are many tick constrained securities with trading inefficiencies that need addressing, but an attempt to do so may risk disruptions worse than the problems we are attempting to solve.

While we are supportive of the Commission's efforts to improve trading efficiency in tick constrained securities, we support a phased rollout given the uncertainty of the outcomes. This will allow time for stakeholders to evaluate the costs and benefits with each new tick increment. For the initial implementation, for securities with a price greater than $1 and time weighted average quote spread of less than $0.016, the new 50 mill tick increment should be applied. After a defined evaluation period, the industry and regulators can evaluate the costs and benefits, using data to inform possible modifications to the spread criteria and tick sizes. Post evaluation, a determination can then be made on additional tick size reductions, the rolling back of the 50 mill tick size, altering the spread criteria, or maintaining the phase one program criteria.

One challenge in a phased approach is the harmonization of trade increments for both on and off exchange trading. While we propose beginning with 50 mill quoting increments and trading increments on exchange, we believe that additional trade price flexibility is warranted for retail investors. The potential loss of price improvement between the best price at the far side of the NBBO and the midpoint would be material. For that reason, we recommend a smaller increment for off exchange trading that is within the Commission's proposed order competition auctions of 10 mills per share. We believe this creates a threshold for material price improvement and preserves flexibility for wholesalers to improve upon the best bid and offer prices in the market. Furthermore, an order competition auction for qualified retail orders would enable institutions and other liquidity providers to compete in 10 mill increments for retail order flow without risking the potential destabilizing effects of quoting in this increment.

Decreasing Access Fees

We are supportive of reducing the access fee cap to 10 mils, and we agree with the concerns the Commission cited in their proposal[2] that the prevailing maker-taker access fee model may:

(1) undermine market transparency since displayed prices do not account for exchange transaction fees or rebates and, therefore, do not reflect the net economic costs of a trade

(2) serve as a way to effectively quote in sub-penny increments on a net basis when the effect of a maker-taker exchange's sub-penny rebate is taken into account even though the minimum quoting increment is expressed in full pennies

(3) introduce unnecessary market complexity through the proliferation of new exchange order types (and new exchanges) designed solely to take advantage of pricing models

(4) drive orders to non-exchange trading centers as market participants seek to avoid the higher fees that exchanges charge to subsidize the rebates they offer to attract liquidity

(5) may benefit sophisticated market participants, like market makers and proprietary traders, at the expense of other market participants

[2] [Release No. 34-96494; File No. S7-30-22] RIN 3235-AN23 Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders- https://www.sec.gov/rules/proposed/2022/34-96494.pdf

Reducing the access fee cap to 10 mills reduces the magnitude of the problems created by the 30 mill fee cap in the market. A fee cap of 10 mills provides ample room for exchanges to create incentives, charge premium or discount prices, and earn a profit, all while lowering the distortive effects they have on the equity market.

Exchange Pricing Transparency

We have long supported increased transparency around fees charged by exchanges[3] and we support the Commission's proposal to amend rule 610 to add a new "Transparency of Fees" subsection as we agree with their assessment of how existing exchange pricing tier models can negatively impact market participants behavior.

Pricing that is not determined until month end creates a captive customer who must maintain levels of qualified trading activity or suffer an adverse economic consequence for up to an entire month's trading activity.

We are supportive of the approach that would require exchanges to use the prior month's volume when setting volume-based tiers, and we agree with the Commission's assessment of benefits of such a change. Specifically, the certainty of the cost of a transaction at time-of would help broker-dealers make better order routing decisions and reduce order routing incentives that are based on achieving a threshold to gain a specific fee or rebate. However, we encourage the Commission to review and address the issue of "bespoke" pricing tiers prevalent in today's volume tiered pricing models.

Acceleration of Redefined Odd Lots

We were supportive of the Market Data Infrastructure (MDI) proposals[4], which included redefining the definition of a round lot and the inclusion of odd lot data on the SIP.

Under this proposal, the Commission is proposing to accelerate the implementation of the revised round lot definitions and amending the odd-lot information definition to require the identification of the best odd-lot order adopted under the MDI rule.

Conclusion

The proposal for Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders is complex, containing interconnected policy updates that will have lasting and broad impact on the US equity markets. Collectively, the proposal seeks to modernize Regulation NMS by targeting key inefficiencies in how securities are quoted and traded and how transactions are priced.

Changes of this magnitude come with unique risks to the stable and efficient functioning of the world's largest equity market. While the benefits of this modernization could be profound, we urge the Commission to stagger the rollout of the new minimum pricing increments specifically as it represents the largest risk to the stability of the equity market. The proposed minimum increments should be adopted

[3] Clearpool comment letter - Re: File No 4-729; SEC Roundtable on Market Data and Market Access; https://www.sec.gov/comments/4-729/4729-4555206-176185.pdf
[4] Clearpool comment letter - Re: Market Data Infrastructure (File No. S7-03-20); https://www.sec.gov/comments/s7-03-20/s70320-7269026-217716.pdf

in phases with each step creating an opportunity for reevaluation of the costs, benefits and needs for further refinement.

Sincerely,

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