August 9, 2023

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

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

Dear Ms. Countryman:

Nasdaq, Inc. ("Nasdaq") writes to provide a supplemental comment (the "Supplemental Letter") on the equity market structure reform proposals that the Securities and Exchange Commission (the "SEC" or the "Commission") published on December 14, 2022.[1] Nasdaq submits this Supplemental Letter to comment further on the portion of the NMS Proposal that would reduce the cap on access fees beyond what is needed to accommodate new, smaller tick sizes, and with the aim of restricting the ability of exchanges to provide meaningful rebates to market participants for providing displayed liquidity to their markets.[2]

Specifically, we write to address two arguments that the Commission, as well as several commenters,[3] use to support the access fee proposals. These arguments are: (1) access fees are

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1 See Securities Exchange Act Release No. 34-96495 (December 14, 2022), 88 FR 128 (January 3, 2023); Securities Exchange Act Release No. 34-96494 (December 14, 2022), 87 FR 80266 (December 29, 2022) (the "NMS Proposal"); Securities Exchange Act Release No. 34-96496 (December 14, 2022), 88 FR 5440 (January 27, 2023); Securities Exchange Act Release No. 34-96493 (December 14, 2022), 88 FR 3786 (January 20, 2023) (collectively, the "Proposals"). Nasdaq submitted a prior comment on the Proposals on March 30, 2023. See Letter from J. Zecca to V. Countryman, SEC, Re: Equity Market Structure Proposals (Mar. 30, 2023), https://www.sec.gov/comments/s7-31-22/s73122-20162299-331153.pdf (the "Initial Comment Letter").

2 In the NMS Proposal, the Commission states that one of its aims in reducing access fees is to "lower the total amount of access fees collected and rebates distributed, reducing, though not eliminating, any distortionary effects of exchange rebates on order routing and likely improving market efficiency." NMS Proposal, supra, at 80303.

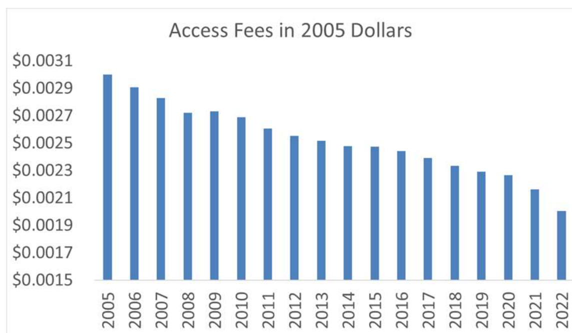
3 See Ltr. from J. Saluzzi, Themis Trading LLC, to V. Countryman, dated March 31, 2023, at 7-8, available at https://www.sec.gov/comments/s7-30-22/s73022-20162966-332937.pdf; Ltr from S. Hall, Better Markets, Inc., to V. Counytryman, dated March 31, 2023, at 15-16, available at https://www.sec.gov/comments/s7-30-22/s73022-20163074-333038.pdf; Ltr. from H. De Jesus, BlackRock, to V. Countryman, dated March 31, 2023, at 10-11, available at https://www.sec.gov/comments/s7-32-22/s73222-20163995-333998.pdf; Ltr. from G. Davis, The Vanguard

unjustifiably high and bear no reasonable relationship to the actual costs of accessing liquidity on exchanges; and (2) investors would benefit from a sharp reduction in access fees. **In short, these arguments are mistaken and misguided, as they place market quality and investor outcomes at risk.**

Access Fee Caps are not Unreasonably High

As we stated in our Initial Comment Letter, the Commission presents no reasonable grounds to assert that the existing access fee cap is or has become unreasonably high. As commenters note, the Commission settled upon a 30 mil access fee cap in 2005 for stocks priced at or above $1.00 based upon access fee levels that prevailed in 2005.[4] They point to the fact that the cap has remained nominally the same, without change, for the ensuing 18 year period. These arguments are misguided.

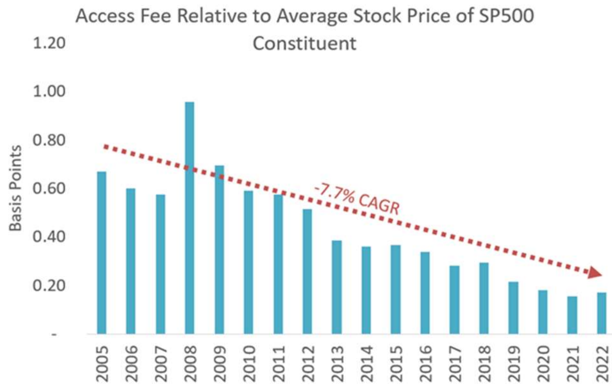
When accounting for inflation, the real cost of the access fee cap has not remained constant. Instead, **the cost of access fees has actually fallen since 2005 by one-third.**



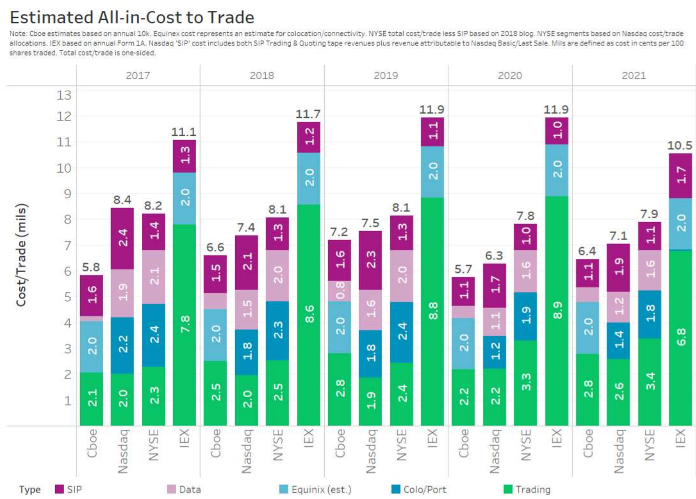
Likewise, access fees have fallen dramatically as a percentage of the average price of an S&P 500 stock since 2005.

Group, LLC, to V. Countryman, dated March 31, 2023, at 6, available at https://www.sec.gov/comments/s7-31-22/s73122-20162793-332197.pdf; Ltr. from J. Mahoney, Council of Institutional Investors, dated March 30, 2023, at 3, available at https://www.sec.gov/comments/s7-31-22/s73122-20162681-331929.pdf.

4 See NMS Proposal, supra, at 80289 ("The current access fee caps were designed to prevent fees from constituting an excessive percentage of the share price and reflected the then current rates that were assessed by trading centers. 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.").



Moreover, the burden of access fees relative to the all-in trading costs of participants has not grown over time; instead, it has remained relatively flat.[5]



While the burden of access fees and rebates has remained flat for market participants and investors, it has become riskier, and thus, more expensive, for liquidity providers to post liquidity on exchanges. As a percentage of S&P 500 prices, market makers already are receiving lower rebates to offset costs that are rising – costs wrought by the fragmentation of liquidity across a proliferating number of venues, the rise of off-exchange trading, and the prevalence of off-exchange segmentation. Such data undermines assertions that access fees have become unjustifiably high.

Some also argue that the Commission should lower the access fee cap because other trading fees have fallen, like retail broker commissions. However, the mere fact that some trading fees have fallen (and fallen organically) does not mean that the Commission, by regulatory rate-making (a power that the Exchange Act does not confer upon the Commission), should force down other fees in concert. If anything, the fact that commissions have fallen

5 We note that retail brokers and investors typically do not currently bear the burden of these fees, as most retail trades are executed off-exchange.

suggests a diminished need for the Commission to intervene to decrease other types of trading fees.

Moreover, it is important to note that participants' costs of trading – in terms of bid-ask spreads – has remained tight over time, not despite the level of access fees, but rather (at least in part) because of access fees and of the market-improving rebates that access fees facilitate. That is, tight spreads are evidence that access fees and rebates are effective, not evidence that they are excessive or unnecessary. Said otherwise, the fact that spreads – and more importantly, the NBBO – have not deteriorated more than one might expect given recent trends demonstrates that rebates are powerful bulwark that keep liquidity from pouring out into the darkness.

The Commission and commenters also argue that technological innovations adopted by exchanges over the past 18 years warrant a lower access fee cap because such innovations have increased operational efficiencies and lowered the actual costs to exchanges of executing trades on their markets. Again, this argument is flawed in several respects.

First and foremost, it misconstrues the nature of access fees as a technology cost recovery mechanism. Technology costs, and improvements thereto, are not significant determinants of access fee levels. As Nasdaq explained in its Initial Comment Letter, access fee and rebate levels do not reflect the simple economic costs of trading. Instead, they reflect the magnitude of risk associated with providing displayed liquidity to the market, as well as the value of the information that quotes provide to the market, and the value to participants of having access to those quotes.[6] Lit quotes provide the market with invaluable information about pricing and liquidity.

Second, even if exchanges' technology and operational costs did drive exchanges' decisions regarding access fee levels, the Commission fails to quantify those costs, determine how, if at all, those costs have changed over time, or assess what revised cap levels are appropriate, given such changed costs. Said otherwise, the Commission presents no cost-based methodology for arriving at the levels of access fee caps it proposes in the NMS Proposal. Thus, to the extent that the Commission believes that access fee caps should bear a reasonable relationship to the actual costs of executing trades on exchanges, the Commission's proposals fail to meet its own standard.[7] As we stated in the Initial Comment Letter, agency action that fails to accomplish its stated objective is arbitrary and capricious.[8]

Even if the above was not the case, and access fees had increased over time (either in a nominal sense, a real sense, or relative to other costs of trading), that fact alone would not warrant the Commission taking the proposed actions. Exchanges do not provide transaction

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6 See Initial Comment Letter, supra, at 22-26.

7 In any event, the Commission's proposal to increase access fees as a percentage of tick size for stocks in the new proposed $0.001 tick bucket is seemingly at odds with the Commission's objectives.

8 See Prometheus Radio Project v. FCC, 652 F.3d 431, 471 (3d Cir. 2011) (vacating as arbitrary and capricious a definitional provision that "lack[ed] a sufficient analytical connection to the primary issue [the] Order intended to address"); see also MCI Telecomms. Corp. v. FCC, 57 F.3d 1136, 1143 (D.C. Cir. 1995) (vacating agency action on other grounds but expressing "serious concerns" that the challenged action did not "promote the agency's stated goal").

services in isolation. Instead, transaction services are part of a platform of related services and products that exchanges provide to market participants.[9] Indeed, exchanges compete with one another on a platform basis, not just on a product-by-product or service-by-service basis. Within the framework of this platform model, the price or relative price of any one exchange product or service at any particular time should not concern the Commission as long as the all-in costs to market participants of utilizing the platform remains competitive. In fact, as the chart above demonstrates, exchange platform costs to market participants have remained competitive over time.

Slashing Access Fees Would Harm, Rather than Help, Retail Investors

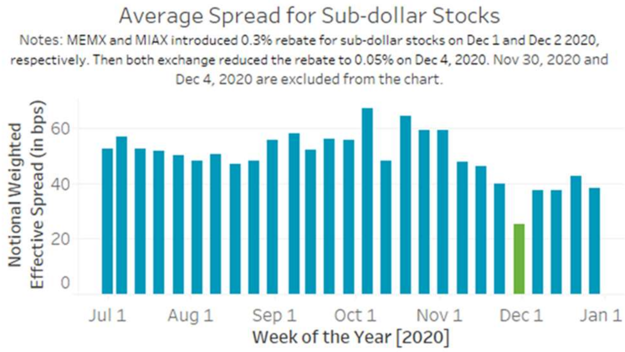
The Commission's proposals also rest upon faulty assumptions that access fees drive up transaction costs for no productive purpose and that slashing those fees would be an easy win for investors. To be sure, we recognize the appeal of this argument to investors and market participants. After all, who wouldn't want to pay lower fees for their stock executions – or for just about anything that they are required to purchase? Unfortunately, this issue is not as straightforward as it appears.

As Chair Gensler has himself cautioned with respect to zero-commission trading, nothing truly valuable is ever really "free" (or in the case of stock transactions, nearly free). [10] Instead, the costs of free or deeply discounted services often are simply hidden or shifted to third parties to bear. **Make no mistake, there would be costs to investors if the Commission slashed access fees to the extent that the Commission proposes.** Such hidden costs would have several related components.

First, spreads would widen if access fees were to become inadequate to fund rebates to market makers and other participants that provide displayed liquidity to the markets. This widening would likely be significant, as the data below suggests. It shows that in early December 2020, when MIAX and MEMX first introduced rebates for sub-dollar stocks, spreads for such stocks fell dramatically, but when MIAX and MEMX then slashed rebates soon thereafter, spreads reverted to their prior levels.

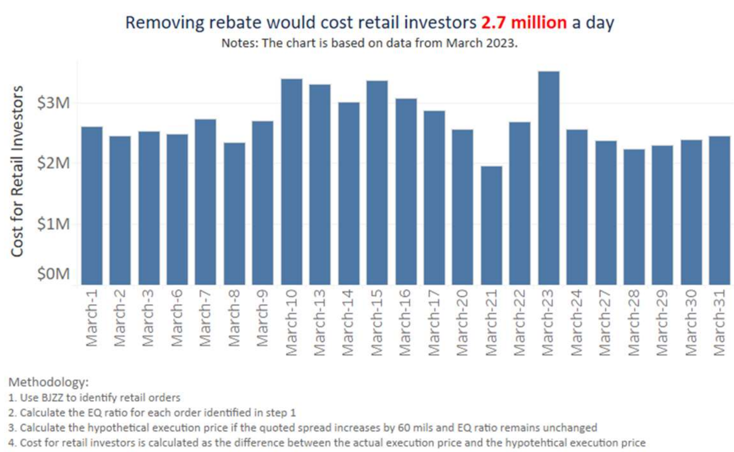
9 Nasdaq plans to publish a white paper on platform theory in the near future.

10 Thomas Franck, "SEC chief Gensler says regulator assessing future of payment for order flow," CNBC, Oct. 19, 2021, at https://www.cnbc.com/2021/10/19/sec-chief-gensler-says-regulator-assessing-payment-for-order-flow.html (quoting Chair Gensler as stating the following: "Our markets have moved to zero commission, but it doesn't mean it's free. There's still payment underneath these applications. And it doesn't mean it's always best execution[.]").



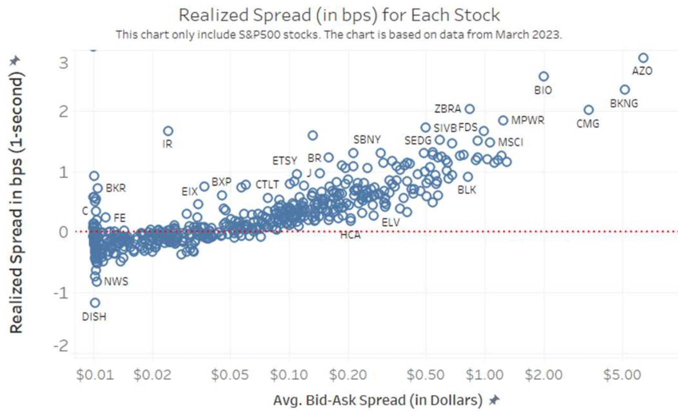
For market makers and other market participants that trade on exchange and would otherwise pay access fees to do so, this spread widening would eat up much of the net cost savings associated with lowering the access fee cap - if not all of it or even more than these savings, arguably, if a vicious cycle takes hold. [11]

Meanwhile, for retail investors and other market participants that typically do not pay access fees now, we estimate that an elimination of fees and rebates, and the ensuing widening of the spread, would **cost retail investors as much as $678 million each year**.

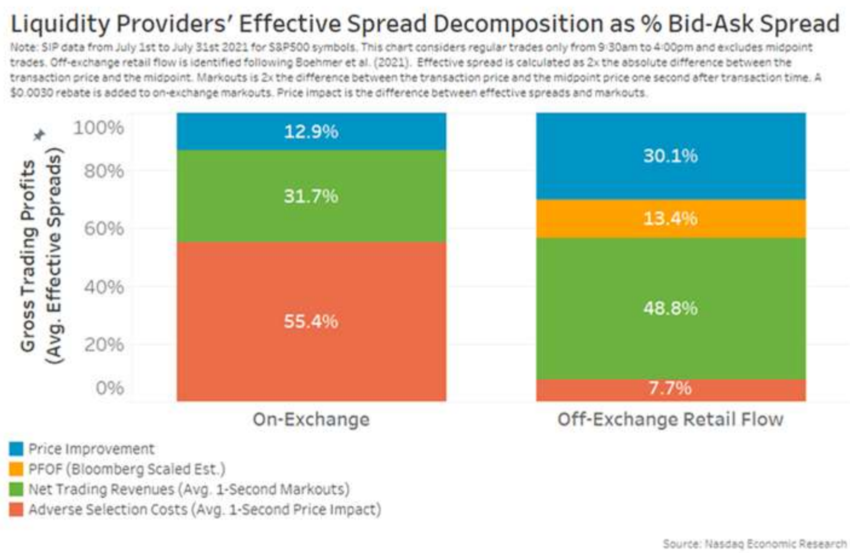


Second, to the extent that market makers and other market participants would lose the rebate as a cushion against the risks associated with making markets and otherwise displaying liquidity on an exchange (which, due to regulatory differences can be harder than providing liquidity bilaterally or on other non-exchange market centers), they may choose to do so less or not at all to avoid those risks. This peril is particularly acute for thinly-traded securities. From the chart below, market makers have negative realized spread for lower priced and tick constrained stocks. Rebates offset these adverse selection costs. A reduction in access fees and rebates would force market makers to widen the spread and/or quote less on exchange, which hurts stock liquidity.

11 See Phil Mackintosh, V is for Volume, and Its Implications for the Access Fee Pilot (Apr. 4, 2019), https://www.nasdaq.com/articles/v-is-for-volume-and-its-implications-for-the-access-fee-pilot.



<u>Third</u>, market makers' effective spreads are greater off exchange. Reducing rebates <u>discourages</u> on-exchange market making. To the extent that more trading occurs in the dark, the NBBO would deteriorate as it would be drawn from a smaller and less representative pool of displayed liquidity.



<u>Fourth</u>, to the extent that off-exchange markets reference the NBBO for pricing, market participants that execute trades off exchange would find that doing so would become more expensive as the NBBO worsens.

Thus, taking such hidden costs into account, not only would the Commission's proposal to slash the access fee cap **<u>fail to save many investors money</u>,** but in fact **<u>it would harm investors by making their stock trades more expensive</u>.**

The Commission's Prospective Rulemaking Proposal to Ban Exchanges from Employing Volume-Based Pricing is Unwarranted and Premature

Lastly, Nasdaq wishes to comment briefly on the most recent version of the Unified Agenda of Regulatory and Deregulatory Actions, which includes a line item indicating that the SEC's Division of Trading and Markets is contemplating whether to recommend that the Commission propose a rule that would prohibit exchanges for employing volume-based pricing for agency-related volume. [12] Putting aside the question of whether such a proposal is warranted and consistent with the Exchange Act (which it is not, as Nasdaq will explain if and when the Commission releases this proposal), the Commission puts its overall regulatory agenda and U.S. equity market structure at risk by rushing out yet another far-reaching change to equity market structure when the ink is not yet dry on its pending access fee and tiered pricing transparency proposals. Indeed, it would be reckless for the Commission to layer changes upon changes upon changes to a fragile and complex ecosystem, without the predicate of a crisis or other exigent circumstances to warrant doing so. We strongly urge the Commission to avoid destabilizing the markets by postponing any new action on exchange fees and pricing until it has an opportunity to determine first whether, and in what form, to adopt its pending proposals on those topics, as well as to evaluate the effects of any proposals it ultimately adopts and implements.

Conclusion

Nasdaq urges the Commission to reflect upon the superficial logic of its fee cap proposal and the absence of evidence underlying it. Given the true nature and history of access fees (and rebates), no compelling evidentiary basis exists to slash them to the levels proposed. This proposal will not bring meaningful or lasting benefits to investors; it will merely provide the veneer of benefits to some, while pushing hidden costs upon others. Thus, this proposal is flawed and it either should be abandoned entirely or amended to provide only for a proportionate reduction in access fee caps as needed to accommodate new, smaller tick sizes.

Sincerely,

John A. Zecca

Cc: The Honorable Gary Gensler, Chairman, SEC
The Honorable Caroline A. Crenshaw, Commissioner, SEC
The Honorable Hester M. Peirce, Commissioner, SEC
The Honorable Jaime Lizárraga, Commissioner, SEC
The Honorable Mark T. Uyeda, Commissioner, SEC
Director Haoxiang Zhu, Division of Trading and Markets

12 See Office of Management and Budget, Spring 2023 Unified Agenda of Regulatory and Deregulatory Actions, Proposed Rule State, Volume-based Exchange Transaction Pricing, RIN 3235-AN29 ("The Division is considering recommending that the Commission propose a new rule under the Securities Exchange Act of 1934 to address concerns with national securities exchange volume-based transaction pricing in NMS stocks by requiring exchanges to make periodic public disclosures about those pricing models to facilitate greater transparency of their impact and to mitigate conflicts of interest and facilitate competition among broker-dealers by prohibiting volume-based pricing by exchanges for agency-related volume."); at https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202304&RIN=3235-AN29.