January 12, 2024

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

Re: Re: Volume-Based Exchange Transaction Pricing for NMS Stocks, Release No. 34-98766; File No. S7-18-23, RIN 3235-AN29
& 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:

I appreciate the opportunity to comment in connection with the SEC's proposed reforms to Regulation NMS and the volume-based exchange transaction pricing rule for NMS stocks. I presently serve as an Associate Professor of Law with tenure at the George Mason University School of Law. I also recently served on the Investor Advisory Committee of the Securities and Exchange Commission and was the chairman of the Market Structure Subcommittee of that Advisory Committee. I am writing in my individual capacity, and my views are my own.

My views are however informed by my work as a professor of securities law. My views are also informed by my recent experience as Senior Counsel and Chief Economist to the House Committee on Financial Services, where I took academic leave from my teaching position to serve from May 2013 until April 2015 as an advisor to Chairman Hensarling on a variety of financial regulatory issues as senior counsel and chief economist to the Chairman.

I write to express my support for the volume-based pricing rule, otherwise referred to as the rebate tiers rule. I write to further express my support for the proposed amendments to Reg NMS rules related to minimum pricing increments, access fees, and transparency of better-priced orders (the "Reg NMS" proposal or "Tick Size" proposal). This comment letter is submitted to the files for both rules because the arguments contained herein cut across both proposals.

To begin, I was struck by a comment in NASDAQ's comment letter to the rebate tiers rule comparing their business model to Instagram and Tiktok. Their first comment letter to the rebate tiers file argues that "Media content platforms like Instagram or TikTok also employ this same model by rewarding those who contribute the most popular, "buzz-worthy" videos; doing so recognizes that such content drives viewership and incents others to contribute content to

those platforms."[1] While the picture in my mind of market structure compliance professionals doing a choreographed Water dance on a video in front of streaming stock price tickers is an interesting visual, and indeed might make for a viral TikTok video, I am not sure the analogy is as helpful to their argument as they believe.

Putting aside that large social media platforms are vastly different than highly regulated exchanges comprised of the national market system, let's not forget that the social media platforms also have made the customer into the product and leveraged the customer's own data against them. We can safely say that business design is not consistent with the exchange regulation objectives of the 34 Act and the 75 Act.

Nasdaq's analogy to the telecom industry is however a powerful analogy and an appropriate analogy to anchor this discussion. It is a comparison that offers appropriate opening framing for this comment letter's discussion about the anticompetitive effects created by rebate tiers paired with artificially above-market access fees. And it shows why analysis of similar anticompetitive and crony capitalist pathologies that have long plagued the telecommunications industry are appropriate for considering issues in exchange business practices, which is where this comment letter begins.

I. *History of Similar Regulatory Rent Seeking and Oligopoly Abuse In Telecommunications To That Seen Today Among The Dominant Three National Stock Exchange Families*

"Like Ma Bell, I got the Ill Communication." Ill Communication, Beastie Boys

In a Foundation for Economic Education piece in 1984, Melvin Barger argued that Ma Bell was not "broken up by the Justice Department" as we are all taught in middle school history class, but instead it lost the cozy relationship it had enjoyed with the government for half a century. Its first CEO Thomas Vail notably said that "public utility giving good service at fair rates should not be subject to competition at unfair rates."

Reader, stay with me as I prove to you that stock exchanges bear a stronger resemblance to the old Ma Bell monopoly/government rent seeking dynamic than they have to any realistic definition of a free market.

This sentiment pervades among large oligopolies that operate with the support of government regulations, mandates to use their services, and regulatory barriers to entry like stock exchanges. All of these phenomena create "economic rents." Economic rents are defined as above normal profits, higher than the profits that a firm would obtain in a competitive

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[1] See NASDAQ Comment Letter at 11, available at https://www.sec.gov/comments/s7-18-23/s71823-319639-830942.pdf

environment.[2] Demsetz described it that "regulation has often been sought because of the inconvenience of competition."[3]

When AT&T negotiated with the FCC to create an interconnected network of lines interoperable with the Bell system, but with the bell system maintained at the center of that system, what appeared to be a pro-market reform in fact served to further entrench the dominant player AT&T at the center of the network, thereby ensuring that other new players would never obtain the level of market penetration that could challenge the dominance of AT&T's system.[4]

In much the same way, the design of the NMS system has served to maintain the dominance of the three oligopoly exchange families. These effects on competition were first identified and anticipated by Commissioners Atkins and Glassman in their notable dissent when Reg NMS was first adopted.[5] The SEC reforms to reduce access fees, a toll on investors that has not been updated for eighteen years since the adoption of Reg NMS and eliminate some of the greatest abuses in rebate tiers will begin to unravel this crony capitalism knot.

Another feature of many national exchanges is price discrimination in the form of rebate tiers. There is a clear line of analogy to be drawn from this distortive practice to the market distortions created by rebate tiers.

The old bell system featured a combination of long distance/business and residential charges. The long distance and business related services were sold at a substantial markup to subsidize below cost telephone service to residential customers. As soon as other long distance carriers were available to compete with the Bell system, they were able to dramatically reduce long distance prices.

In the same way, ATS platforms have been able to provide access to their platforms at 10 mils. But unlike the downfall of the old Bell monopoly, a lot of order flow still has to go to exchanges that can then use their oligopoly power to charge above market access fees at 30 mils.
If the government had forced residential telephones to use Ma Bell's higher cost long distance, and denied them access to cheaper options like MCI, Ma Bell's monopoly power would have persisted. This is exactly how equity market structure has evolved and why the Reg NMS adjustments to access fees, and to abusive rebate tier practices, are so important.

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[2] Thierer, Adam D. and Skorup, Brent, A History of Cronyism and Capture in the Information Technology Sector (July 1, 2013). Journal of Technology Law & Policy, Vol. 18, 2013, Available at SSRN: https://ssrn.com/abstract=2288082 or http://dx.doi.org/10.2139/ssrn.2288082 at 7, citing Mitchell

[3] Theirer and Skorup at 9, citing Demsetz.

[4] Thierer and Skorup at 20.

[5] Dissent of Commissioners Cynthia A. Glassman and Paul S. Atkins to the Adoption of Regulation NMS , https://www.sec.gov/files/rules/final/34-51808-dissent.pdf

In short, access fees subsidize the rebate tiers that can be used to maintain dominance over a network of order flow in the same way that above market, long-distance charges were able to subsidize residential service at below market rates to maintain monopoly power over the residential market.

The history of American business is filled with examples of this unholy alliance of business and government regulators. The railroads and telephone companies both used their relationship with their regulators to establish regulatory moats around their businesses that allowed them to maintain dominant market positions.

The executives of these businesses would deride any attempt to undo the regulatory barriers that supported their monopoly or efforts to constrain their abuse of it as harming “the free market.” But the market wasn’t free as use of their services was effectively mandated. These national utilities had become so intertwined with the government that they were indistinguishable from it.

National Stock Exchanges are the modern-day equivalent of this phenomenon. They are self-regulatory entities enshrined with power to regulate their members and listed firms, indeed some of the most significant financial services legislation of the last twenty years empowers exchanges as quasi-government regulators.

Efforts to remove the regulatory-generated rents are often decried as interference with the free market, as was the case throughout AT&T’s rein over telephone systems and as also occurred during the era of broadcast television as the FCC utilized it’s power over retransmission consent negotiations.[6] Thomas Hazlett documents a similar dynamic in radio with the longstanding practices at the FCC of rationing spectrum and grandfathering incumbent providers from new rules that limited new entrants.

The status quo among stock exchanges is hardly a free market design, so changing it can move the needle in favor of more market friendly outcomes. National exchanges presently get the benefit of a rigorous licensure process that keeps competitors out.

A large share of trades are required to flow to exchanges because of execution and broker rules. Exchanges get self-regulatory powers that let them operate as quasi-government entities. Exchanges are also a functional oligopoly, where three controlling owners of a larger family of exchanges control the overwhelming majority of exchange execution.

What have they done with these powers? The captured flow that exchanges obtain through regulatory privilege is surveilled and then used to feed information to high-speed customers to jump their orders ahead of retail flow. Access fees, the proverbial bouncers fee at the door, are charged to this mandated flow at three times the rate of flow on competing ATS platforms. These function as a regulatory tax on retail trades backed up by outdated regulatory rules that,

[6] Thierer and Skorup at 33.

while the markets have modernized and technologies have advanced since 2005, have remained fixed at extraordinary high rates of 30 mils.

Some customers obtain preferential rebates, a sort of kickback to encourage additional flow to the exchange. Those rebates are provided in tiers that price discriminate and squeeze every drop of the benefits of the trade to the exchange. Those rebates are also top heavy, and leave small and mid-sized brokers out in the cold.

The SEC's reasonable proposals would eliminate the most abusive rebate practices and decrease the access fees on exchanges to the average prices on ATS platforms. Both are reasonable suggestions to address this unholy alliance of government regulation and exchange abuse of their quasi-government power. A full scale rethink of Reg NMS's problems (along the lines of those anticipated by dissenting Republican Commissioners at the time of its adoption in 2001) would be better, but this is a good start.

Critics of the new stock exchange rules argue it will harm the free market. AT&T was known to cry wolf in similar fashion every time a rule was adopted that threatened its dominance of the American telephone market. The same refrains pervade among large oligopolies that operate with the support of government regulations, which mandates to use their services, and enjoy regulatory barriers to entry like the old Ma Bell did and as stock exchanges still do. In heavily regulated and oligopolistic markets, self-professed defenders of the free market are often crony capitalists wearing libertarian masks.

In A History of Cronyism and Capture In The Information Technology Sector, Theirer and Skorup argue that "cronyism and government granted privilege are…creeping into the modern high-tech and Internet-related sectors."[7] Thierer and Skorup review the history of Ma Bell and other telecom utility regulation and argue that the modern day development of the internet and other tech companies appears to mirror this history.

Professor Tom Hazlett, former Chief Economist at the FCC, urged that in his space of telecom regulation, the FCC's initials should be interpreted to mean "forever captured by corporations."[8] AT&T only became AT&T because of regulation, it's market power was a direct result of its relationship with its regulator and the regulations that flowed from the FCC.[9]

The historical lessons we can draw from the telephone and other utility sectors, and the emerging issues they identified in the emerging tech and social media spaces, both have strong parallels to the cronyism apparent in the dominance of large stock exchanges in the post-NMS trading environment for exchange trading.

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[7] Thierer and Skorup at 3.

[8] See Theirer and Skorup at 16.

[9] See Thierer and Skorup at 18.

Thierer and Skorup note that the history of both airline and railroad industries are strong examples of the observation from Harold Demsetz that when "regulation has often been sought because of the inconvenience of competition."[10] This is true of national stock exchanges as well. A principal way in which exchanges are unique and exhibit this phenomenon, and not representative of your typical "free market" actor, is that they are creatures of regulatory license operating in an environment where the terms of trade are set by exchanges, who have quasi-government power as SROs, and in an environment of a partial regulatory mandate to utilize their services.

The SEC's statutory mandate as competition regulator, a competition focus which former Commissioners Atkins and Glassman referenced in their dissent that accurately predicted these problems would ensue with the original NMS design, can be a solution to this problem. If the government had forced residential telephones to use Ma Bell's higher cost long distance, and denied them access to cheaper options like MCI, Ma Bell's monopoly power would have persisted. This is exactly why equity market structure must continue to evolve and why the Reg NMS adjustments to access fees, and to abusive rebate tier practices, are so important.

II. The Importance of the SEC's Mission as Competition Regulator To Break the Regulatory Rent Seeking By Oligopoly Exchanges

The SEC as a Competition Regulator

The SEC's mission extends beyond the commonly cited tripartite goals of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation. As evidenced by recent statements from SEC officials, there's a recognition that fostering competition is intrinsically linked to these objectives. Mandated by Congress in enumerated statutory objectives, the SEC must ensure "fair competition" among brokers and dealers, and among exchanges, in the national market system.[11]

Competitive markets are more likely to be efficient, promote capital formation, and protect investors. As such, the SEC's regulatory actions that target anti-competitive practices align with its broader mandate to ensure robust competition in capital markets.[12]

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[10] Harold Demsetz, Why Regulate Utilities? 11 J.L. Econ. no.1, 1968, at 61.

[11] *See* 15 U.S.C. 78k-1(a)(1)(C) (finding it in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure fair competition among brokers and dealers, and among exchange markets); *see also* 15 U.S.C. 78f(b)(8) requiring that the rules of an exchange not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act).

[12] In explaining the SEC's statutory mandate to consider, in part, the impact of new rules on competition, a speech by former Commissioner Robert Jackson emphasized that this requires the SEC to conduct a form of antitrust analysis on the result of its rules on the market. This is supported by a memorandum of understanding between the Department of Justice and the SEC regarding anti-trust issues, and it's supported by a number of cases in which the SEC competition mandate has been described as a requirement to effectively service an antitrust regulator, particularly for stock exchanges. https://www.sec.gov/news/speech/speech-jackson-101118

The more that the SEC reviews, assesses, and oversees competition as markets evolve with this new batch of market structure rules in the market structure context and particularly with respect to access fees and rebate tiers where it could be most useful, and the more that particular components of the SEC see that mission as their primary focus, the more that an SEC competition focus can serve to counter the self-perpetuating cycle of an unbalanced market.

A competition focus from the Commission on this issue can help to point a spotlight onto the regulatory barriers to entry that Reg NMS has created and move the Commission toward removing rules that perversely incentivize orders to route in a particular way. As long as those are in force, the Commission's effort to reduce the access fee ceiling that oligopoly exchanges can charge and eliminate price discrimination based rent seeking and rent transfer mechanisms that exchanges are using, as embodied in these pending rule packages, is the next best free market oriented option.

The competition focus could be sort of Schelling Point[13] that focuses the commission comprehensively on the aggregate competition issues that have arisen in market structure in the 18 years since Reg NMS was adopted (rather than the one off competition analysis conducted in each individual rule) and helps to unwind rules or limit abuse practices that are facilitated by rules like rebate, tiers and access fees as above market, economic rents, facilitated by the current rulebook. With that the SEC can begin to unwind the oligopoly power of the three dominant exchange families, in the same way that the monopoly power of industries was eventually addressed in telecom regulation to open up markets to more competition on the basis of price and quality, rather than on the basis of behavior in this instance, rebate tears and above market access fees charged on mandated order routing.

There are other objectives of the SEC implicated here, that stand somewhat outside the four corners of economic analysis, but that nevertheless are controlling. The fairness objective that is unique to the SEC regulations also supports the SEC evidentiary record and defending these two new proposals.[14]

III. *Price Discrimination Is A Pernicious Practice, Deserving of Particular Competition Scrutiny*

Price discrimination, in the context of exchange volume rebates, refers to the practice where exchanges offer different rates or rebates to firms based on the volume of trades they conduct. In this instance the rebate tier is even more limiting as it is based on the total daily market volumes of the entire national market system (not just on the exchange)- so this further

[13] See https://en.wikipedia.org/wiki/Focal_point_(game_theory).

[14] For a more extensive and law review length argument for why the SEC enjoys extensive and essentially plenary authority to adopt fairness centered fee practice rules in the market structure context, See J.W. Verret, Albany Law Review (forthcoming 2024) Robinhood's Threat to Sue the SEC Over Broker-Inducement Regulation Unlikely to Succeed (November 30, 2021). George Mason Law & Economics Research Paper No. 21-38, Available at SSRN: https://ssrn.com/abstract=3974960 or http://dx.doi.org/10.2139/ssrn.3974960

restricts the group of recipients who could qualify for the rebate. This practice can lead to a concentration of trading among a few large players, as they receive disproportionate advantages over smaller participants. Economic theory and legal precedent both suggest that such discrimination can distort markets. For one, it can create an unequal playing field, where large firms gain an advantage not because of better performance or services, but simply due to their size and trading volume. This undermines the competitive structure that is essential for efficiency and fairness in the market.

Furthermore, price discrimination can lead to allocative inefficiency, where resources are not distributed in a manner that maximizes consumer (or in this case, investor) welfare. Economic analyses demonstrate that price discrimination can extract all consumer surplus for the providers of a service, leaving consumers worse off. This is particularly concerning in financial markets, where the cost of such inefficiency can cascade through the economy.

The antitrust concerns around price discrimination have been well-established in legal discourse. The Clayton Act, for example, prohibits certain forms of price discrimination because they can lessen competition or tend to create a monopoly. The Act recognizes that discriminatory prices can harm competition by allowing dominant players to leverage their market power to the detriment of competitors and consumers alike.

Analogy to Other Markets

Price discrimination is not a phenomenon unique to the securities markets. It has been observed in various industries, from airlines to pharmaceuticals, often drawing regulatory scrutiny. The airline industry, for instance, employs sophisticated price discrimination strategies that segment consumers by willingness to pay, often leading to consumer complaints and calls for regulatory interventions. Similarly, in pharmaceuticals, price discrimination has been a subject of intense debate, particularly when it leads to access issues for essential medicines. These examples highlight the broader economic and social implications of price discrimination, reinforcing the need for careful regulation. And it has led to substantial antitrust liability in some of these contexts for some of these firms.

By drawing parallels to these industries, the argument against price discrimination in securities exchanges becomes clearer. If unchecked, such practices can solidify market power in the hands of a few, stifle competition, and ultimately harm the broader base of consumers and investors.

In the next part of the argument, we will delve deeper into the specifics of how volume-based rebates function and the ways in which they can distort market competition. We will also analyze further how the SEC's proposed rule aligns with antitrust principles and fosters a more equitable market structure.

Volume-based rebates, as employed by exchanges, offer reduced fees or rebates to broker-dealers based on the volume of trades they execute. On the surface, this may appear as a

reward for loyalty or a bulk discount, but the economics of such rebates raise significant concerns about market fairness and competition. Large broker-dealers can achieve a lower cost per trade compared to smaller players, not through more efficient operations, but through a rebate structure that disproportionately rewards them for their size.

This rebate system effectively imposes a tiered pricing scheme that can be anticompetitive, as well as discriminatory and an inequitable allocation of fees. When a few large players receive the majority of the rebates, they can afford to trade more aggressively, further increasing their volume and the rebates they receive—creating a feedback loop that entrenches their dominant position. This can result in secondary-line and tertiary-line harm to competition and an exacerbation of inequality, where smaller players in the market suffer because they cannot access the same competitive prices as the dominant firms, leading to a loss of sales and market share.

The Antitrust Lens: Price Discrimination as a Competitive Harm

Under antitrust law, like the Robinson-Patman Act and in other contexts, price discrimination is illegal when it has the potential to harm competition. This harm is not limited to the immediate buyer but can extend to downstream markets and ultimately, consumers. The Act focuses on the impact of discriminatory pricing on competition rather than on individual competitors. This perspective is crucial when considering the effects of volume-based rebates in the securities exchange market. The rebates can have a substantial effect on the ability of smaller firms to compete, potentially leading to reduced market diversity and resilience.

In the context of the SEC's proposal, the analogy to antitrust principles is clear. Just as antitrust law seeks to prevent price discrimination from undermining competition, the SEC is proposing to limit volume-based rebates to prevent large players from using their market power to the detriment of the market as a whole.

The Role of Economic Argument Against Price Discrimination

Economically, price discrimination is often associated with a monopoly or market power, where a provider can set prices differently across different consumer groups. However, the harm in financial markets is more nuanced—it doesn't merely result in higher prices for some, but it also affects market liquidity, price discovery, and ultimately, the integrity of financial markets. Markets thrive on competition, and when few players are capable of setting the terms, the market is no longer free, but rather, controlled by the dominant players' pricing strategies.

The problem is not just a matter of fairness among market participants. It extends to the overall efficiency and health of the financial ecosystem. Smaller market participants often drive innovation and provide services to niche segments that larger entities may overlook. When these smaller players are squeezed out by discriminatory pricing practices, the entire market suffers from reduced innovation and a lack of comprehensive service provision.

Justifying Volume-Based Rebates: An Economic Perspective

In the broader economic literature on price discrimination there are at times economic benefits associated with the practice such as economies of scale or the provision of additional services. However, in the case of volume-based rebate tiers implemented by exchanges, the justification often falls short as the pricing strategies serve as barriers to competition and often go against the interests of the ultimate customer— the investors. While large players may indeed achieve economies of scale, the rebate system as currently structured seems to exceed such justifications and instead creates barriers to entry and expansion for smaller firms.

Economies of scale should reduce costs for all market participants as they grow, not just the largest ones. The current rebate system does not appear to provide a level playing field where all can benefit from increased efficiencies. Instead, it tilts the field in favor of those who already dominate the market. This goes against the principles of competitive neutrality and could be seen as a form of economic distortion.

In the next part, we will continue to explore how volume-based rebates impact the competitive landscape and align our findings with the principles of antitrust law and the SEC's mandate. We will also examine the potential impacts of the SEC's rule change on market dynamics, including the arguments for and against the proposal from various stakeholders in the market.

Impact on Competitive Landscape

The competitive landscape in financial markets is particularly sensitive to pricing strategies due to the high velocity of transactions and the slim margins on individual trades. In such an environment, volume-based rebates can significantly tilt the market. They not only give larger firms an advantage on costs but can also impact the access to liquidity for all market participants. Smaller firms may find it increasingly difficult to compete, not because they lack expertise or efficiency, but simply because they cannot match the rebate-earned cost reductions of their larger counterparts.

This imbalance raises concerns about the concentration of market power. Such concentration can lead to less innovation, reduced market entry, and increased prices for consumers, contrary to the SEC's goal of fostering a competitive and fair marketplace.

Aligning with Antitrust Principles

Antitrust laws, particularly those focused on price discrimination, serve to maintain competition by ensuring that no single market participant can distort the market through unfair pricing strategies. In the context of volume-based rebates, the SEC's proposal to limit them is akin to enforcing antitrust principles within the securities market. By restricting the ability of large players to leverage their size for additional discounts, the SEC is upholding its duty to protect the competitive process.

Considering Market Dynamics

A critical examination of the market dynamics reveals that while volume-based rebates could theoretically incentivize market participation and liquidity, in practice, they often result in a concentration of market power. This concentration can lead to a feedback loop where only the largest players benefit, reinforcing their position and making it more challenging for new entrants to compete. The SEC’s proposal, by limiting these rebates, aims to disrupt this loop and promote a more diverse and competitive market.

The SEC's Mandate and Proposal Justification

The SEC’s mandate includes ensuring fair competition, and by limiting volume-based rebates, the Commission is addressing the disproportionate advantages that currently exist. This proposal aligns with the SEC's role as a de facto competition regulator within the financial markets, ensuring that all players, regardless of size, can compete on an equal footing. By doing so, the SEC also supports market integrity and investor confidence, both of which are critical for the proper functioning of capital markets.

In the next part of the argument, we will focus on the broader implications of limiting volume-based rebates for market efficiency and investor protection. We will also delve into the international context, comparing the SEC’s approach to similar regulatory frameworks in other jurisdictions, and evaluating the potential global impact of the rule change.

Market Efficiency and Investor Protection

The SEC's proposal to limit volume-based rebates is rooted in the principle that market efficiency is best achieved in a competitive, non-discriminatory environment. When large players receive volume-based rebates, it creates a market distortion where trading decisions may be driven more by the potential for rebates than by underlying market fundamentals. This can lead to an inefficient allocation of resources and skewed price discovery mechanisms, with detrimental effects on market efficiency and investor protection.

Moreover, smaller market participants often serve specialized roles within the financial ecosystem, catering to niche markets and contributing to the overall liquidity and stability of the financial system. By enabling these players to compete on more equal terms, the SEC's proposed rule would likely enhance market resilience and protect investors from the systemic risks associated with market concentration.

International Regulatory Context

Internationally, the issue of exchange volume rebates has been addressed by various regulators, with a focus on ensuring fair competition and preventing market abuse. The European Union's Markets in Financial Instruments Directive (MiFID II), for instance, imposes stringent transparency and reporting requirements that aim to reduce the potential for market

manipulation, including practices related to rebate schemes. By proposing to limit volume-based rebates, the SEC would be aligning its regulatory stance more closely with international best practices that promote competitive neutrality and market integrity.

Economic Theory and Price Discrimination

Economically, limiting volume-based rebates challenges the status quo of price discrimination, which can create market inefficiencies and barriers to entry. By aligning trading costs more closely with actual market activity rather than volume incentives, the SEC fosters a more equitable environment where market success is based on performance and innovation rather than on economies of scale alone.

Antitrust Principles and Fair Competition

The SEC's stance resonates with core antitrust principles that seek to prevent business practices that could harm competition. Volume-based rebates, as currently structured, mirror the types of pricing strategies that antitrust laws like the Robinson-Patman Act were designed to prevent. By curtailing these rebates, the SEC proactively mitigates the risk of market concentration and the creation of de facto monopolies in the securities exchange market.

It is important to include the context of the SEC's Memorandum of Understanding (MOU) with the Department of Justice Antitrust Division to emphasize the SEC's role in promoting competition in financial markets. Here's how this MOU and the SEC's proposal to limit volume-based rebate tiers connect to assert the SEC's competition regulatory role.

The MOU between the SEC and the DOJ's Antitrust Division symbolizes a historic collaboration focused on maintaining competitive markets.[15] This partnership allows for a more comprehensive approach to market oversight, integrating the SEC's expertise in securities with the DOJ's antitrust enforcement capabilities. While it is the SEC's role to regulate anticompetitive issues within exchange markets, the SEC can use by analogy applicable and relevant precedent from cases in other antitrust contexts in which rebate tiers have been abused to further anticompetitive activity under the antitrust laws.

The SEC's approach to market reform, including the rules on rebate tiers, reflects empirical evidence and robust economic analysis, which is a cornerstone of antitrust regulatory action. By grounding its proposal in data and analysis, the SEC is acting on its mandate to foster fair and efficient markets, akin to the objectives of antitrust law which aims to prevent practices that can hinder competition.

In conclusion, the SEC's proposed rule to limit volume-based rebate tiers and its memorandum with the DOJ's Antitrust Division signify a concerted effort to embrace its role as a competition regulator within the financial markets. These actions demonstrate a commitment to principles that are at the heart of antitrust regulation: preventing practices that distort competition,

[15] https://www.sec.gov/news/press-release/2020-140

promoting transparency, and protecting investors from the kind of market inefficiencies that anticompetitive behaviors often produce.

The Regulatory Tax on Trading Reexamined

These proposed reforms are grounded in sound economic principles and empirical analysis that highlight the market distortions created by existing fee structures and rebate systems employed by national exchanges. Access fees charged to broker-dealers and other market participants simply to access liquidity on certain exchanges often greatly exceed the actual costs associated with providing that liquidity access. At the same time, complex rebate systems that offer volume-based kickbacks and financial incentives are artificially segmenting order flow in ways that undermine principles of fairness and equitable access that are foundational to efficient market operations.

The Commission's proposals to lower the access fee cap closer to levels reflective of actual access costs, as seen on competing trading platforms, combined with judicious adjustments to reign in abusive volume-based rebate practices, will collectively help realign market incentives. The current incentives are skewed to benefit select market participants in ways that the Commission rightly understands can hinder capital formation, dampen competition, limit investor choice, and ultimately undermine broader market quality to the detriment of investors and public companies alike.

The Commission has rightly justified these reforms based on the multiple ways in which unchecked exchange access fees and incentives from rebates ultimately undermine efficient markets. From an economic standpoint, access fees that greatly exceed the actual costs of liquidity access act as a tax on trades that raises trading costs for investors. Estimates suggest that excess access fees charged by exchanges amount to over $30 billion in the last 15 years compared to access fees changes on competing platforms. This effective regulatory tax on trades routed to exchanges due to market structure rules distorts order routing decisions and results in higher trading costs passed down to the end investor.

Additionally, complex rebate systems that disproportionately direct funds to the very largest exchange customers, create imbalances that introduce further distortive forces into order routing practices. When the prospect of a higher rebate influences broker order routing decisions rather than the genuine best interest of trade execution quality for their customer, then these rebates can reasonably be seen as introducing problems under fiduciary law. The tiered nature of rebates, that left unchecked under the Commission's proposal could imbue 87% of rebate funds to just three large exchange participants, means that smaller brokers are not able to access reasonably comparable pricing. This price discrimination dynamic means that ultimately costs are higher market wide than they would be in the presence of fair competition on the merits.

This staggering figure represents an enormous tax on retail investors resulting from the combination of above-market access fees and price discriminatory rebate practices that harm

market competition. Beyond the direct cost impacts, these distortionary pricing dynamics have harmed price discovery, lowered market transparency around execution quality, and dampened meaningful competition between exchanges around service quality rather than volume incentives.

The concentration of volume among the very largest exchange participants as a result of the flaws in Regulation NMS's market structure framework have also created conflicts of interest. Predatory trading practices such as latency arbitrage extract billions annually from market participants by exploiting privileged access to information within unstable exchange systems. By reforming the underlying financial incentives provided to the very fastest traders under the current access fee and rebate regime, positive cascading effects will improve market stability while also encouraging exchanges to compete more actively on actual execution quality. Significantly, the Commission's proposed rule recognizes that in the current market structure ecosystem characterized by dominant exchange oligopolies and a sizable portion of volume required to route directly to exchanges, the Commission must take an active role in oversight around exchange pricing practices and structures.

Relying solely on competitive market forces to discipline pricing behaviors has resulted in the aforementioned anti-competitive dynamics around access fees and rebate tiers. Just as the SEC has stepped in to regulate exchange pricing that was resulting in illegal off-exchange trading decades ago, so too must the SEC adapt its regulatory approach to modern exchange fee and rebate practices that evidence shows are undermining efficient markets.

The exchange landscape today is characterized by an oligopoly of three exchange families controlling over 90% of exchange volume. This concentration of control, when combined with certain privileged regulatory status afforded to exchanges, demands heightened oversight when it is evident that exchanges are abusing pricing powers in ways that conflict with the Commission's mission. Unchecked, exchanges have imposed access fees exponentially higher than warranted by the marginal cost of connectivity and liquidity access while also utilizing complex rebate schemes to effectively pay for order flow.

These practices run counter to the transparency and fairness principles that the Commission has outlined as essential components of efficient markets. They allow select market participants to utilize pricing leverage to disadvantage smaller competitors. And they have drained profits away from brokers to subsidize predatory trading practices by privileging those exploiting instability for profit over those acting as patient capital providing liquidity to markets. This market structure has degraded capital formation and hampered fair competition - two goals that the Commission must prioritize in reforming the dysfunctional incentives around exchange fee practices.

The Commission's proposed access fee cap that is 70% below current levels combined with sensible constraints around disproportionate rebates merely brings equilibrium and fairness back to exchange fee structures. Contrary to criticisms that this represents government overreach, these pricing decisions are precisely where SEC oversight is essential and wholly

appropriate. Exchanges enjoy substantial regulatory privilege, including immunity from litigation, self-regulatory authority, and trading volume requirements that make their pricing decisions a matter of critical public interest.

Just as the SEC reviews and provides parameters around listing standards as a check against exchanges overreaching, fee structure guidelines serve a parallel function in counteracting the documented history of exchange fee abuses when left unchecked.

In this area, the Commission is rightfully reasserting oversight powers that are not only appropriate but imperative. As this comment letter has explored, exchanges today enjoy a privileged status as self-regulatory organizations while also concentrating power over trading infrastructure that necessitates regulatory checks against overreach that harms market quality. Unconstrained access fees and complex rebate systems have drained profits from brokers to cross-subsidize destabilizing practices by select exchange participants. This is the very definition of abused pricing power.

The proposed access fee cap and constraints on disproportionate rebates directly target these documented harms. They raise trading revenues for brokers who play an essential role in capital formation and ensure fairer pricing across diverse exchange participants rather than reinforcing the dominance of select liquidity removers. These pricing reforms will help counteract documented conflicts of interest, curb systemic risks associated with volume concentration, and promote exchange competition around actual execution services rather than volume incentives alone.

In enacting Regulation NMS and establishing the national market system framework, the Commission made certain assumptions about competitive dynamics between exchanges and brokers that have simply not manifested. Rather than fair competition, an oligopoly has emerged that charges exponentially above-market fees subsidizing practices that analysis suggests reduces investor returns and dampens price discovery.

In reasserting sensible pricing constraints, the Commission is rebalancing the competitive landscape closer to the vision that Regulation NMS originally intended rather than overstepping regulatory authority.

The proposed rule's allowances for justifiable variances in exchange fee pricing structures affirms that the Commission is not seeking to undermine beneficial market innovations. But in setting guardrails around access fee levels and proportionality of rebates, the SEC injects greater fairness into exchange pricing decisions that will cascade through the entire equity ecosystem to the benefit of issuers and investors alike.

IV. Measuring the Costs and Regulatory Taxes Represented By Above Market Access Fees and Rebate Tier Distortions

Mancur Olson's *The Logic of Collective Action* describes the problem of concentrated benefits but distributed costs, and how that dynamic leads the beneficiaries to have sharper incentives for push to maintain their benefits where the costs of those transfers results from dispersed groups that find it more difficult to engage collectively.

This problem of collective action has been exhibited in government taxation and spending, but it can also be exhibited in regulation.

And in market structure, this problem of concentrated benefits but distributed costs is compounded by the skillfully hidden nature of those benefits and costs. The retail investor sees that the direct commission paid on a trade is low or zero, but they do not see that the actual cost of a trade, because of a regulatory tax on their trades caused by a top-heavy and discriminatory rebate tier structure or because of the regulatory tax of above-market access fees for flow that is required to go to exchanges, functions as a hidden regulatory tax on their trades.

In terms of calculating that cost, one way is to compare access fees across platforms. I have come to a rough estimate of $30 billion in above market economic rents enjoyed by exchanges as a result of above market access fees and distortionary impacts from rebate tiers.
This number is derived by looking at exchange volumes from Jan 2008 – August 2023, then estimating what portion of exchange volume was executed where the remover paid 30 mils/share. Then, taking that volume and multiplying it by 20 mils (since that is the difference between the 30 mils paid and the 10 mils that would've been paid, had that been the access fee decided).[16]

One way to calculate the cost of rebate tiers is through consideration of the distortionary behavior that these rebate tiers subsidize for the exchange. One cost of these distortive processes is that it subsidized less productive uses than would be present in a system without the misallocation of investment resulting from cronyism.[17]
Zywicki presents an argument that these distortions should be viewed as a form of zero sum game.

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[16] **Calculation details:**

- The amount of venue-by-venue market volume is publicly known, so I aggregated on-exchange daily volumes from 2008 thru 2023 YTD. The volume for which 30 mils to access liquidity is charged takes place on "maker-taker" exchanges (BZX, EDGX, MEMX, MIAX, Nasdaq, NYSE, NYSE Arca, Nasdaq PSX). Some portion of volume on these venues comes from auctions, and some small percentage does not pay 30 mils. I assumed that 10% of the "eligible" volume is from auctions, and, of the remaining 90%, 95% pays 30 mils. I then multiplied the remaining "eligible" volume by 20 mils (the difference between 30 mils paid and what would've been paid if access fees were 10 mils) – the number is $30bn from 2008 to 2023 YTD. The cost each year is reasonably consistent just because it is tied to market volume over time. The more volume, the higher the cost. This is the regulatory tax that routing mandates and volume tiers conspire together to create, a portion of which is paid to some of the sources of that flow in the form of rebate tiers.

[17] See Thierer and Skorup at 14.

Another estimate puts the costs of one particular type of conflicted distortion in trading, latency arbitrage, at $5 billion per year.[18]

The rent seeking practices that are the hallmark of the crony capitalism dynamic, achieved via regulatory capture, are in some ways more pernicious in the instance of large exchange rebate tier practices and the above market access fees that help to fund those rebates.

Their distortionary nature, and the black box nature of some order, matching within off exchange venues that partner with exchanges, makes it difficult to quantify the impact of the distortion, including an estimate of $5 billion a year in cost resulting from one particular practice, latency arbitrage, which is facilitated by unequal access to trading data, which is a function of three exchange family dominance, which captures order flow using both regulatory mandates and anti-competitive rebate tier practices.

Exchanges are not normal players in the free market. They obtain regulatory privilege that forces some trades to be routed to exchanges. The field of licensed exchanges are dominate by three exchange families who serve as the platform for the overwhelming majority of trades on exchanges.

The 3 dominate families of national exchanges then force those trading on the exchange to pay an access fee of 30 mils, rather than the 10 mils common on ATS platforms. That difference is used to subsidize rebate tiering practices that distort trade flows and perpetuate price discriminatory practices that are anticompetitive.

This is a particular challenge with the structure of stock exchange order matching. The real cost to the ultimate beneficiary of the trade, whether retail trader or public pension beneficiary, is hidden within a black box of trade execution. The visible commission can be zero but the cost of execution can be higher in indirect distortions from high speed frontrunning. One estimate of the cost of latency arbitrage on the market puts it at $5 billion per year.[19]

This business design also bears a similarity to social networks. There are implicit costs to service provided "for free", but the user is the product, market data and connectivity subsidize direct trading costs, and information about trading patterns translates into higher cost execution for the mass informed and less sophisticated market participants. It is even more pernicious than the old regulatory monopolies created in the telecom space because customers don't see the real fee, it seems "free" but economists as well as cafeteria workers appreciate that there is no such thing as a free lunch.

A 2022 analysis by Greenwich Associates underscored the concentration of exchange market share among a handful of dominant market makers. The study found that the top five

[18] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-50.pdf?mod=article_inline
[19] https://www.cnbc.com/2020/01/27/latency-arbitrage-trading-costs-investors-5-billion-a-year-study.html

wholesalers accounted for over 50% of US equity volume across exchanges.[20] These wholesalers are also among the highest volume exchange participants that disproportionately benefit from existing rebate tier systems.

This consolidation of liquidity and exchange routing volume raises concerns over concentration of market power while also highlighting the relatively few players disproportionately benefitting from status quo rebate structures. It bolsters the case for the Commission addressing problematic rebate schemes.

V. *Issues at the Intersection of the Private Non-Delegation Doctrine and Exchanges as SROs*

The private non-delegation doctrine, a cornerstone of administrative law, mandates that essential regulatory powers vested in a federal agency cannot be delegated to private entities. This principle is particularly relevant in the context of Self-Regulatory Organizations (SROs), like stock exchanges, that operate at the intersection of private management and public regulatory functions.

The private non-delegation doctrine limits the ability of private entities in exercising the force of government regulatory power to instances in which private entities are subordinate to a federal government agency. In the recent case *National Horseman's Benevolent and Protective Association v. Federal Trade Commission* (the "NHBPA case"), a congressional delegation of self-regulatory authority to a horseracing trade association was struck down for violation of the private non-delegation doctrine.[21]

The NHBPA case involved the creation by Congress of the Horseracing Integrity and Safety Authority, which was granted self-regulatory powers or "SRO" status and housed under the general authority of the Federal Trade Commission (the "FTC") with limits on the FTC's ability to review its rules.[22] The SRO was able to propose rules to the FTC, which the FTC was required to approve if those rules were consistent with the authority granted to the SRO, limiting the FTC's authority to only proposing modifications of the SRO's rules.[23]

These restrictions on the FTC's ability to review, modify, or abolish rules of the Horseracing Integrity and Safety Authority were ultimately what led the Fifth Circuit to strike down the organization's self-regulatory authority under the private non-delegation doctrine. And while the FTC was granted the ability to adopt interim final rules under a "good cause" standard, this

[20] https://www.greenwich.com/equities/2022-us-equity-trading-market-highlights
[21] NHBA at 1.
[22] NHBA at 3.
[23] NHBA at 3.

limitation actually bolstered the court's ruling that the statute violated the private non-delegation doctrine.

The court looked at who was really "in the saddle" when making policy judgments and setting industry fee programs and found the construct did not follow the clear hierarchy mandated by the constitutional private non-delegation doctrine.

The limitations on the FTC's authority in the NHBPA case bear a remarkable similarity to the limits on SEC review of stock exchange fees and trading practices that certain exchanges have alleged exist in various comment letters regarding the recent proposed market structure rules related to SRO fees. And indeed, one of the types of rules at issue in the NHBPA case were fee assessments promulgated by the horseracing SRO, which furthers the precedential import of this case for the exchange SRO rules at issue, which also regulate fee practices.

Ultimately, the manner in which the delegation of power to a private SRO was struck down in the NHBPA case complicates the threat from large exchanges to challenge the SEC's market structure reform proposals on access fees and the more recent volume-based rebate tier reform proposal. In short, as recent case law has highlighted, SROs are only allowed to exist as self-regulatory organizations that wield regulatory privileges, consistent with the Constitution, so long as that role acts as an aid to a government agency, allowing the agency to retain substantial discretion to modify or disapprove of an SRO's fee structures. The arguments that the large exchanges have made happen to be inconsistent with these constitutional parameters, as has been brought to light in the disallowance of a similar private-agency construct in the horseracing industry.

The stock exchange SROs have argued in comment letters that the SEC is limited by economic cost benefit analysis and statutory analysis in its ability to adopt these rules with a description of those limits that is eerily similar to the limits that were the death knell for the horseracing SRO.

For example, in a comment letter NASDAQ argues:

"Even if changes to exchanges' costs of trading was a valid basis for reducing the access fee cap, the Commission still fails to establish what is the actual cost to an exchange of a trade, the level of access fee cap that would constitute a reasonable relationship to that cost, and most importantly, that the SEC's proposed reduced fee caps do, in fact, bear a reasonable relationship to the actual costs to an exchange of a trade. The tasks of determining such costs and setting appropriate rates based upon those costs are inherently difficult, especially in an industry with diverse participants and business models; these are tasks that a government agency like the Commission is ill-suited to tackle and from which it should refrain."[24]

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[24] See https://www.sec.gov/comments/s7-31-22/s73122-20162299-331153.pdf at page 22.

NASDAQ's description of the SEC's role in reviewing the access fees set by exchanges is entirely inconsistent with what is required of SEC oversight of exchanges by cases like NHBA pursuant to the private non-delegation doctrine, as well as U.S. Supreme Court cases dating back to the 1930's, such as *Carter v. Carter Coal Co.*, and the many cases that have since followed.

Conferring regulatory powers to private entities mandates the adherence to the private non-delegation doctrine, which requires the regulatory agency to independently review, assess, and modify the actions of the private SRO, particularly when it comes to determining equitable fee structures where cronyism and regulatory conferred oligopoly power is enjoyed.
NASDAQ further argues:

"*the SEC merely assumes that rebates present a conflict of interest to brokers that is harmful to investors, and that the harmful effects of that conflict are substantial enough and costly enough to justify the Proposal's drastic reductions to the existing access fee caps. That type of unsubstantiated assumption is insufficient to justify a rulemaking that has the potential to upend the way in which exchanges incentivize market quality.*"[25]
In so arguing, NASDAQ makes two critical mistakes. It once again fails to appreciate the constitutional framework necessitated by the private non-delegation doctrine for SEC review of stock exchange SROs like NASDAQ. And NASDAQ further fails to appreciate that the multi-factor test created by the 75 Act amendments allows fairness considerations to alone justify exchange fee rules independently of economic analysis.

The fact that the FTC "can't review" the SRO's rules was dispositive, and the court held that "[a]n agency does not have meaningful oversight if it does not write the rules, cannot change them, and cannot second-guess their substance."[26] The arguments made of large exchanges in the comment letter process thus far amounts to an argument that, when it comes to stock exchanges access fees and rebate tiers, the SEC does not write the rules, cannot change them, and cannot second guess their substance.

The FTC was granted the ability to adopt interim final rules under a good cause standard, a limitation which the court found as part of the reason the statute violated the private non-delegation doctrine.[27]

This case at a minimum has implications for the economic cost benefit analysis and for the fairness/statutory factor analysis required of the SEC and will act to shift the strong burden created by *Business Roundtable v. SEC* away from the Commission and toward a challenging exchange SRO plaintiff.

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[25] https://www.sec.gov/comments/s7-31-22/s73122-20162299-331153.pdf at page 26.

[26] NHBA at 3.

[27] NHBA at 12.

If the exchanges are correct about that, then the private non-delegation ruling in NHBA v. FTC will dismantle the existing exchange SRO model. At a minimum, the NHBA case will shift the burden in challenging rules to the exchange SROs.

While the NHBA case recognized that the SEC's oversight of FINRA has been upheld under the private non-delegation doctrine, that doesn't mean that the type of deferential relationship that dominant stock exchanges seem to think they enjoy with the SEC will be upheld under the private nondelegation doctrine as well. Indeed, the relationship some exchanges seem to believe they enjoy with the SEC is remarkably similar to the design struck down in NHBA v FTC. FINRA has survived private non-delegation scrutiny because the SEC retains authority to "abrogate, add to, and delete from" FINRA rules "as the [SEC] deems necessary or appropriate.[28] FINRA survives private non-delegation because FINRA's role is "'in aid of' the SEC, which has the final word on the substance of rules."[29]

Either this framing is true with respect to exchange rules regarding access fees and rebates, in which case the SEC's proposals will survive challenge by the exchanges and the exchanges will face a heavy burden in their challenge. Or it's not, in which case the exchange SRO model itself may come crashing down.

Nasdaq's "Fees and Rebates as Boiling Frog" Argument

Nasdaq's comment letter makes the interesting argument that "Over decades, the SEC had countless opportunities to review exchange fee filings based upon volume-based pricing. It had every opportunity raise concerns and suspend or disapprove these filings, but by and large it did not do so."[30] The anticompetitive landscape that evolved over the course of the last 18 years since the adoption of Regulation NMS has evolved over the course of many incremental, slowly ratcheting changes in the magnitude and form of price discriminatory approaches. NASDAQ's position would turn the SEC's review of exchange fees and rebates into a boiling frog that not only doesn't notice the pot slowly boiling, but that isn't allowed to jump out of the slowly heating pot altogether. That would be a convenient position for an oligopoly exchange enjoying the benefit of routing mandates, I grant you that. But it simply isn't the law.

The SEC has authority to review fee practices going back to the 34 Act and greatly enhanced by the 75 Act amendments.[31] Indeed, far from something to celebrate, the Buttonwood

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[28] NHBA at 30, citing Aslin v. FINRA.

[29] NHBA at 30.

[30] NASDAQ Comment Letter at page 13, available at https://www.sec.gov/comments/s7-18-23/s71823-319639-830942.pdf.

[31] *See e.g.*, Section 11A (Commission authority to establish the national market system to ensure fairness among other objectives); Section 23(a) (Commission's broad rulemaking authority); Section 6(b)(4), (5), (8) (Commission must assure equitable allocation of reasonable fees, prevent unfair discrimination, and not allow SRO rules to impose a burden on competition not necessary or appropriate in furtherance of the Act); Section 6(e)(2) (Commission may abrogate any SRO fee rule if no longer reasonable, in the public interest, or necessary to

agreement in 1792 that is celebrated as a founded document of what became the NYSE, was principally an anticompetitive a price fixing agreement that did nothing more than eliminate competing brokers and fix prices at .25%! The legislative history shows that a long history of anticompetitive fee practices was at the forefront of Congress's mind in adopting both the 34 Act and the 75 Act. Statutory authority with respect to exchange fee practices is clear, and the burden is on the exchange to justify their fees and rebates, not the other way around.

VI. A Variety of Arguments In Support of Access Fee Caps and Rebate Tier Guardrails

This next section summarizes several interrelated issues in which access fee and rebate tier reform are implicated.

Information Asymmetry: In much the same way that the PII associated with the CAT reforms was problematic, so too does information leakage from the quantity and price of stock matched for trading constitute a privacy leak for retail customers, this conflict is exacerbated by rebate practices that encourage firms to chase the top rebate tiers.

Impact on Smaller Brokers and Innovators: Large exchanges currently dominate the market by offering volume-based rebates to their biggest customers, which typically are a handful of the largest brokers. This creates a significant barrier to entry for smaller and mid-sized brokers and new platforms, including those licensed exchanges seeking to innovate with advanced technologies and better execution performance for investors. The SEC's proposal to limit these rebates can level the playing field, giving smaller entities a fighting chance to compete and innovate. This, in turn, can foster a more competitive marketplace and encourage the introduction of new technologies and products to the market.

Market Concentration Risks: The big three exchanges benefit from volume-based rebates, reinforcing their already dominant market positions. This concentration of market power can impede the entry and scaling of smaller brokerages that lack the volume to qualify for such rebates. If allowed to persist, these rebates can entrench the oligopoly of the big exchanges, making it difficult for brokerages to offer competitive pricing and services, which are crucial for their growth and the broader adoption of trading platforms. By prohibiting volume-based rebate tiers, the SEC can ensure that smaller brokerage firms have a fair chance to compete, innovate, and contribute to a diversified and dynamic market. This aligns with the SEC's objectives of maintaining fair, orderly, and efficient markets, and promotes the kind of competition that can lead to better outcomes for all market participants.

Access to Liquidity: Rebate tiers create a liquidity imbalance, where the bulk of displayed trading volume is attracted to the big three exchanges due to the financial incentives they offer to large traders who are incentivized to accumulate rebates instead of obtaining the best prices for investors. This also leaves smaller brokerages at a disadvantage when it comes to providing

accomplish the purposes of the Act); Section 19(c) (Commission may abrogate, add to, delete from, referred to as "amend," the rules of an SRO to ensure the fair administration of the SRO or to further the purposes of the Act).

liquidity for their customers. Without liquidity and fair access to it, the growth of competitive trading platforms that focus on best execution and performance for the benefit of investors will likely be curtailed.

Strategic Alliances and Market Dynamics: The oligopoly power of the big exchanges allows them to form strategic alliances with major market players, further consolidating their market strength. This could lead to a situation where brokerages are forced out of the market or into less favorable positions, reducing the diversity of trading platforms available to investors and potentially slowing down the innovation pace set by these smaller, more agile firms.

Long-Term Consumer Impact: If the big three exchanges continue to use rebate tiers to maintain their oligopoly, the ultimate losers will be consumers. They will face fewer choices, higher costs, poorer executions, and a lack of innovative products that brokerages can offer. This runs counter to the broader market trends towards democratization of finance and the need for greater inclusion facilitated by innovative technologies.

Market Integrity and Trust: The big three exchanges' use of rebate tiers can be perceived as a mechanism that creates an uneven playing field, potentially eroding trust in the financial markets. Trust is particularly important for the adoption of new technologies that enhance trading performance and execution. By ensuring that rebate practices do not disproportionately benefit the largest players, the SEC would be upholding market integrity and fostering a climate of trust that encourages investment and innovation in efforts by brokerages and exchanges.

Diversity of Strategies: Smaller brokerage firms often experiment with diverse trading strategies that are not reliant on high volumes, such as offering niche assets. However, the lure of rebates on large exchanges may draw liquidity away from these innovative strategies, undermining their viability. Limiting rebates could thus protect the ecological diversity of trading strategies, which is essential for a robust and resilient financial ecosystem.

Price Discovery and Efficiency: Effective price discovery is crucial for the efficient functioning of the markets. The concentration of trading activity in the big three exchanges due to rebate tiers can lead to a distortion in the price discovery process. Smaller firms, with their innovative products, are instrumental in providing alternative venues that enhance price discovery. The SEC's intervention to limit rebates can empower these firms to contribute more significantly to market efficiency.

Encouraging Technological Adoption: By discouraging rebate tiers, the SEC would not just be promoting competition but also technological adoption. Smaller brokerages are typically more agile and quicker to adopt new technologies, such as the blockchain, which can lead to broader technological advancements across the financial sector. The SEC's action would thus be a nod towards the importance of technological progress within finance.

Investor Choice and Better Outcomes: A competitive market with a multitude of players, including smaller brokerages, translates into better choices for investors. When investors have

a range of options, including innovative products, they are better positioned to manage their investment risks and rewards. Limiting rebate tiers would prevent large exchanges from using pricing strategies to crowd out these choices.

Promotion of Cross-Sector Collaboration: By limiting the ability of large exchanges to monopolize market share through rebates, the SEC would promote a collaborative environment where TradFi institutions might be more inclined to partner with innovative firms. Such cross-sector collaboration can lead to the development of hybrid products that combine the best of both worlds, offering new investment opportunities and enhancing market depth.

Fostering Fair Competition: Rebate tiers can create a feedback loop where the largest exchanges attract the most volume due to the rebates they offer, which in turn allows them to offer even higher rebates. By limiting these rebates, the SEC would break this loop, fostering fair competition where market success is based on service quality and innovation, rather than the ability to offer kickbacks. This would greatly benefit smaller brokerages attempting to compete based on the merits of their innovative offerings.

Reducing Systemic Risk: Concentrated trading on a few large exchanges increases systemic risk. Diverse and distributed trading across multiple platforms, including those operated by small and mid-size brokerages, can mitigate this risk. The SEC's move to limit rebates could encourage a dispersion of trading activity, thereby enhancing the systemic resilience of the financial markets.

Enabling Scalability for Startups: Startups and smaller brokerages often face significant challenges in scaling their operations due to the significant financial benefits enjoyed by larger players. By reducing the rebate incentives, the SEC could lower the barriers to scale, enabling these smaller players to expand their services and user base more effectively.

Promoting Transparency: One of the fundamental principles of the SEC is to promote transparency in financial markets. Rebate tiers, by their nature, can create complex and opaque pricing structures that are difficult for market participants to navigate. By simplifying this landscape, the SEC would be enhancing transparency, which is in line with the objectives under the Exchange Act.

Boosting Market Participation: The high concentration of trading within the big three exchanges can discourage market participation by retail and smaller institutional investors due to perceived unfair advantages. By leveling the playing field, the SEC could boost market participation by making it more attractive for these investors to engage with smaller and mid-sized innovative brokerages and exchanges.

Encouraging Financial Inclusion: By reducing the concentration of power amongst the selected few largest brokers, the SEC would be supporting financial inclusion and the democratization of investment opportunities.

VII. Point/Counterpoint, Address Your Critics Head On

In evaluating the Commission's vital reforms to address documented harms from unchecked exchange fee and rebate schemes, it is important to explore key criticisms raised and provide balance through reasoned counterarguments.

Criticism - Market Forces Should Dictate Pricing

The argument surfaced by some exchange representatives opposed to Commission oversight on pricing decisions essentially amounts to letting market forces determine appropriate fee levels, including both access fees and rebates. However, this perspective ignores the reality that exchanges are not purely private businesses. They enjoy substantial regulatory privilege, government-protected oligopolies, and mandated volume requirements that necessitate a greater degree of oversight when pricing decisions risk undermining market quality. Relying on self-regulatory organizations to make pricing decisions has directly led to them favoring their own commercial preferences and the anti-competitive dynamics around access fees and rebate structures that the SEC reform proposal aims to now correct after nearly two decades of inaction.

Counter - Regulatory Oversight Required to Check Abuses

Exchanges act more akin to utilities dependent on government infrastructure than fierce free market competitors, notwithstanding the demutualization of exchanges over the last several decades. Their pricing decisions can adversely impact costs and behaviors far beyond their own narrow business interests. As such oversight acts as a logical check against the conflicts of interest inherent in entities that combine profit-seeking agendas with industry self-governance powers. The Commission serves a vital role in ensuring pricing equilibrium that exchanges have proven unable - or unwilling - to offer when afforded pricing latitude historically.

Criticism - Consumers Benefit from Rebates

Some claim that the savings large brokerages achieve from volume-based rebates may trickle down to consumers in the form of lower trading commissions or reduced fees. But evidence exploring nearly two decades of exchange rebates offers little indication that such savings transfers have occurred in any meaningful capacity. Rather, brokers have often pocketed extra profits or used funds to subsidize other business initiatives rather than passing rebate savings down to the end consumer. This critique also ignores the fact that the tiered nature of rebates often excludes mid-sized and smaller brokers from earning significant rebates in the first place due to volume thresholds. As such, their customers face a competitive cost disadvantage relative to patrons of large brokerages benefitting disproportionately from existing rebate structures.

Counter - Rebate Tier Distortions Outweigh Unlikely Benefit Transfers

The remote possibility of indirect savings transfers does not outweigh the immediate and quantifiable market distortions induced by disproportionate volume-based rebate models that foster conflicts of interest, concentration of market power, and higher baseline trading costs from inflated access fees that cross-subsidize rebates. The Commission rightfully recognizes that potential trickle down benefits arising from pricing decisions that directly undermine market quality amount to logical fallacy rather than sound justification

VIII. *Let's Get To The Point*

In conclusion, I believe that the proposed amendments to Reg NMS rules regarding minimum pricing increments and the proposed reforms to volume/access fees both support the core principles of free market economics and will lead to a more competitive, transparent, and efficient market landscape.

I encourage the SEC to adopt the both proposals and continue striving for market-driven solutions that benefit all market participants.

I thank you for considering this comment letter.

Sincerely,

J.W. Verret

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