March 23, 2023

By Email

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 205499–1090
rule-comments@sec.gov

Re: Rule Proposal No. 34-96495; File No. S7-31-22 Order Competition Rule

"Internalization is one of the greatest threats to price discovery in financial markets." - Kenneth Griffin[1]

Ms. Countryman:

I appreciate the opportunity to comment on the U.S. Securities and Exchange Commission's (the "SEC" or "Commission") Order Competition Rule Proposal (the "OCR Proposal").

I'm a college graduate of St. Mary's College of California, working professional, and retail investor.

It seems clear to me that our markets aren't functioning properly. There should be open, transparent, and fair competition for order flow. Rule makers and regulators should use their extensive powers and authority to further these goals.

The largest financial institutions and corporations that are against substantive change obviously do not want this to happen simply because it negatively impacts their bottom line. And that is exactly what needs to happen for anything to change, and for markets to be more fair. Citadel CEO Ken Griffin expressed his own unease over market structure in 2004 when he said "unfettered internalization will result in substantially poor executions for all retail and institutional investors." Today he stands in support of the market structure he so fiercely opposed, simply because his company benefits from it.

The fundamental flaws in our market structure are plain to see. I support open competition for order flow, and also believe that innovation and competition are healthy forces for finding optimal economic outcomes.

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[1] Griffin, Kenneth, "Comment Letter–Re: Regulation NMS - File No. S7-10-04", Securities and Exchange Commission, Available at https://www.sec.gov/rules/proposed/s71004/s71004-436.pdf ("Ken Griffin Hates Internalization")

Below is an edited excerpt from Dave Lauer and We The Investors, whose sentiment I agree with completely:

I support a simple Trade-At rule modeled on the Canadian rule[2], as discussed in the alternatives section of the OCR Proposal. The Canadian rule[3] can be summarized in two sentences:

- Small, non-block orders can only be executed off-exchange if they receive material price improvement; and
- Material price improvement is defined as a full tick if the spread is more than a tick wide, or at the midpoint if the spread is a tick wide.

Trade-At has several compelling advantages over the current OCR Proposal:

- Simplicity: Trade-At is not a prescriptive rule. It allows exchanges to compete for order flow based on execution quality and innovation. They are welcome to build auction facilities for individual investor orders, and the Commission could even allow for certain benefits (e.g., smaller trade increments) if these facilities fulfill certain requirements.
- Open Competition: Trade-At recognizes that the best competition for order flow happens at the NBBO, and provides the best incentive for lit liquidity and trading. The benefits of competing at and strengthening the NBBO accrue to all market participants.

Why is Trade-At our preferred solution? In seeking to reduce internalization and off-exchange trading to promote more efficient price discovery and lit liquidity diversity, we must be mindful of unintended consequences. A Trade-At rule is the least likely approach to be gamed. This is because simpler rules are more difficult to game than complex rules.

Moreover, in seeking to reduce internalization and off-exchange trading to promote more efficient price discovery and lit liquidity diversity, we must be mindful of unintended consequences. A Trade-At rule would minimize unintended consequences and has been tried successfully in the U.S. in the past.

The rule would also facilitate market dynamics that nearly all participants agree are important. Specifically, there is broad consensus that open competition for order flow provides the best outcomes for all participants.

A Trade-At rule would also address the problems below:

1. Markets are less liquid and more fragile due to fragmentation. The U.S. markets have devolved into a needlessly complex and elaborate apparatus with enough levers and buttons to confuse Rube Goldberg. Worse yet, the result is a system in which any order

[2] It is important that the Commission ensure that material price improvement is required for any off-exchange trading of small orders. The Commission has recognized this in the OCR Proposal, only allowing trades to be internalized at the midpoint. This is the same benchmark we would urge for a Trade-At rule.

[3] IIROC-OCRCVM at 6.6, “Annotated Universal Market Integrity Rules”, (March 1, 2023), Available at https://www.iiroc.ca/media/1021/download?inline#%5B%7B%22num%22%3A315%2C%22gen%22%3A0%7D%2C%7B%22name%22%3A%22FitR%22%7D%2C-289%2C-5%2C901%2C796%5D

that would be desirable to trade against is segmented and isolated off-exchange. The only trading that does take place on-exchange is against toxic orders with high adverse selection.

2. Market participants are increasingly concentrated. As the Hu-Murphy paper and our own analysis have shown, the off-exchange market for OTC trading is "highly concentrated."[4] U.S. markets are stuck in a concentration feedback loop both on- and off-exchange. Increasing amounts of off-exchange trading have driven increases in adverse selection on-exchange. The firms that can best navigate that increase are those with scale, speed and access to better information, such as data on off-exchange order flow characteristics. The firms that operate exclusive flash order facilities have a distinct informational advantage over firms operating on-exchange, resulting in an increase of information asymmetries, reduction of profitable on-exchange trading opportunities, and reduction in the diversity of on-exchange market makers and market making strategies. What has been the result of this concentration feedback loop? According to IEX, from 2013 - 2021, "the number of exchange members declined 44% on Nasdaq, 26% on NYSE, and 69% on NYSE Arca. The number of specialists or designated market makers on the floor of the NYSE has declined from 25 in 2000 to only 3 today."[5] This is the exact opposite outcome that policymakers want. It is also precisely what has led to the drop in liquidity and increase in market fragility.
3. "Price improvement" and "size improvement" are only provided through exclusive flash order facilities. We believe that price and size improvement should be determined by the market, not bestowed upon "fortunate" investors at the behest of oligopolists. If wholesalers are truly providing competitive execution quality and price improvement, there is every reason to believe they would still do so in the face of open competition. First, a Trade-At rule will narrow spreads more than any other option the Commission is considering by ensuring that the majority of pricing competition takes place at the NBBO. This will reduce transaction costs materially, and mitigate the need for price improvement. Second, a Trade-At rule will allow exchanges to design facilities that can provide price and size improvement. Moreover, fair access requirements ensure that the maximum number and type of participants can compete in such facilities.

There have been some notable supporters of a Trade-At rule:

- Virtu Financial
    - "We appreciate the aim of the Pilot's "Trade-At" requirement, applicable to securities in Pilot Group 3, of facilitating and enhancing the price discovery mechanism on National Stock Exchanges."[6]

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[4] U.S. Department of Justice, "Herfindahl-Hirschman Index", (July 31, 2018), Available at https://www.justice.gov/atr/herfindahl-hirschman-index

[5] Ramsay, John, "Comment Letter-Re: File No. S7-30-22; Release No. 34-96494; Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders", Securities and Exchange Commission (SEC), (March 20, 2023)

[6] Cifu, Doug, "Comment Letter–Re: Proposed National Market System Plan To Implement a Tick Size

- Virtu was a founding working group member of the Healthy Markets Association in 2015, whose second highest priority was to establish a Trade-At rule.
- Virtu publicly endorsed[7] the so-called "Grand Bargain" explained below.

- Citadel
  - "Internalization is one of the greatest threats to price discovery in financial markets."[8]
  - "Internalization without meaningful price improvement reduces competition, limits price discovery, leads to market fragmentation and should be banned."[9]
  - Broker-dealers should be permitted to internalize an order "only if the broker-dealer is already quoting on an immediately accessible electronic market at the NBBO for a size no less than the size of the order the broker-dealer is seeking to internalize."[10]
- New York Stock Exchange and Others
  - In 2015, the NYSE and Credit Suisse announced a "Grand Bargain", "that would, among other things, ban maker-taker pricing schemes at trading venues because in their view they add to market complexity and the appearance of conflicts of interests, reduce the access fee cap for trading centers from $0.003 per share to $0.0005 per share, and contemporaneously adopt an industry-wide "Trade-At" rule."[11] This of course makes their recent opposition to the OCR Proposal even more perplexing. Perhaps they should blink twice if Citadel is holding their order flow hostage.

Improving the Auction Proposal

If the Commission chooses not to adopt a Trade-At rule, there are important changes that could be made to the OCR Proposal to reduce unintended consequences and create a competitive, transparent environment. The OCR Proposal is overly prescriptive, and the final rule should allow for greater innovation among qualified auction facilities.

For example, a batch auction structure is far more compelling and likely beneficial than the proposed call auction structure. I do not claim to know, however, which should be used when, and which option will provide the best outcomes under various security and liquidity

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Pilot Program on a One-Year Pilot Basis", Virtu Financial, (Dec. 19, 2014), Available at https://virtu-www.s3.amazonaws.com/uploads/documents/2014.12.19-Virtus-Comment-Letter-Proposed-National-Market-System-Plan-To-Implement-a-Tick-Size-Pilot-Program-on-a-One-Year-Pilot-Basis.pdf

[7] Cifu, Doug, "*no arguments from me! Never asked and never needed any of that stuff. Simple transparent and fair*," [Tweet], Twitter, Available at https://twitter.com/Dougielarge/status/545911383070875649

[8] Ken Griffin Hates Internalization

[9] Cooper, Adam, "Comment Letter–Re: Release No. 34-49175; File No. S7-07-04 — Competitive Developments in the Options Markets", Securities and Exchange Commission, Available at https://www.sec.gov/rules/concept/s70704/citadel04132004.pdf

[10] Ken Griffin Hates Internalization

[11] Securities and Exchange Commission ("SEC") Division of Trading and Markets, "Memorandum–Re: Maker-Taker Fees on Equities Exchanges", (Oct. 20, 2015), p. 6-7, Available at https://www.sec.gov/spotlight/emsac/memo-maker-taker-fees-on-equities-exchanges.pdf

circumstances. Therefore I believe the OCR Proposal should be amended to allow for both types of auctions.

Further the time period of 100ms - 300ms is too long, and too likely to result in unintended consequences as it becomes very likely that continuous order book changes can happen during this time period. 100ms is likely the longest time necessary to ensure robust participation from both on-exchange traders and institutional investor order-routing algorithms.

I agree that the concerns expressed by both Proof Trading and BestEx Research regarding information leakage in these auction facilities, and further agree that "one way the SEC proposal could be tweaked to reduce information leakage for institutional investors would be to omit side from the order attributes that are mandated to be exposed in auction messages."[12]

Finally, I do not believe that any form of PFOF should be allowed in markets and urge the Commission to ban PFOF in all forms. Allowing rebates for qualified auctions is antithetical to the notion that retail brokers must route orders based on execution quality, rather than fee structure. Furthermore, if the Commission continues to allow such a fundamentally flawed and conflicted practice to persist, it would be especially dangerous to allow brokers who route orders to qualified auctions to have such volume counted towards other volume-based fee tiers on exchanges.

Conclusion

The crazy thing to me is that supporters of the status quo are fighting like their firms won't exist anymore or something. This is all about potential revenue loss for them

Industry firms that fear change are simply afraid about potential revenue loss. That's it. That's all they're fighting for. And it's clear because so many of them spoke out against regulations in the past, that today they benefit from. This whole thing is about incentives and inducements. The Commission should seek to create fair, level, transparent ground where open competition for order flow can determine winners and losers in markets. I support the efforts made by the Commission and believe that a simple Trade-At rule will be more effective at accomplishing those goals.

Sincerely,

Bailey Hardwick
Jr. Analyst - Barnard Investments

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[12] Bishop, Allison, "Comment Letter–Re: Order Competition Rule, Release No. 34-96495; File No. S7-31-22", Proof Trading, (Feb. 8, 2023), Available at https://www.sec.gov/comments/s7-31-22/s73122-20156866-325036.pdf